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No. 89-____

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

W.R. GRACE & CO.-CONN. and
GRACE PETROLEUM CORPORATION,

Petitioners,

—v.—

FEDERAL DEPOSIT INSURANCE CORPORATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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112 pp

QUESTIONS PRESENTED

1. May the Federal Deposit Insurance Corporation ("FDIC"), an agency of the federal government, recover punitive damages in a common law fraud action without statutory authorization to do so? If so, do the Fifth, Eighth and Fourteenth Amendments permit such an award to the government by a jury given unbridled authority to punish as it saw fit?

2. Where the government, for its own tactical reasons, fails to submit any evidence of its damages at trial, is it consistent with due process and the sound conservation of federal judicial resources to permit a second jury trial for the sole purpose of giving the government another opportunity to prove compensatory and punitive damages?

3. If so, is it permissible under the Seventh Amendment and the rule of *Gasoline Products Co.* v. *Champlin Refining Co.*, 283 U.S. 494 (1931), to retry damages without retrying liability as well, when the compensatory and punitive damage issues are inextricably intertwined with issues of liability considered by the first jury in reaching its general verdict?

PARTIES TO THE PROCEEDING

This action was commenced in 1984 by the Continental Illinois National Bank ("Bank" or "Continental") against the captioned petitioners.[1] Shortly thereafter, the FDIC was substituted for the Bank, which had assigned its loans, including the loan that is the subject of this action, to the FDIC as part of the government's bail-out of Continental.

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1 Pursuant to Supreme Court Rule 28.1, we advise the Court that Grace Petroleum Corporation is a wholly-owned subsidiary of W.R. Grace & Co.-Conn., which is a wholly-owned subsidiary of W.R. Grace & Co., a publicly traded company. Petitioners are here collectively called "Grace".

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—v.—

FEDERAL DEPOSIT INSURANCE CORPORATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioners respectfully pray that a writ of certiorari issue to review the decision of the United States Court of Appeals for the Seventh Circuit entered in this action in appeal No. 88-2275 on June 21, 1989.

OPINIONS BELOW

The opinion of the court of appeals is reported at 877 F.2d 614, and is reprinted in the Appendix ("App.") hereto at p. 1A, *et seq.* The *per curiam* Order of the court of appeals denying Grace's petition for rehearing and suggestion for rehearing *en banc* is reprinted at App. 54A. The opinion of the district court denying Grace's motion for judgment n.o.v. is reported at 691 F. Supp. 87, and is reprinted at App. 16A, *et seq.* The unre-

ported memorandum opinion and order of the district court granting in part and denying in part Grace's motion for summary judgment is reprinted at App. 40A, *et seq.*

JURISDICTION

The decision and judgment of the court of appeals was entered on June 21, 1989, and a timely petition for rehearing and suggestion for rehearing *en banc* was denied on September 11, 1989. The jurisdiction of the Court is invoked under 28 U.S.C. § 1254(1) (1982).

APPLICABLE CONSTITUTIONAL PROVISIONS AND STATUTES

The pertinent texts of the Fifth, Seventh, Eighth and Fourteenth Amendments to the United States Constitution and the FDIC's enabling statute, the Federal Deposit Insurance Act, 12 U.S.C. §§ 1811 *et seq.*, are set out at App. 74A, *et seq.*

STATEMENT OF THE CASE

In May 1980, Grace purchased from Centex Corporation a fifty percent interest in certain gas reserves in Mississippi, relying on the Bank's written agreement to finance most of the purchase price with a $75 million non-recourse loan to Grace. The loan, made shortly thereafter, was to be repaid, with premium interest, only from the proceeds of the sale of gas from the purchased property. At the time the Bank was already extending credit to Centex secured by these same properties.

It turned out that the properties were not as productive as had been anticipated by either the Bank or Grace. Because of this, and because of an unforeseen decline in energy prices generally, the properties yielded revenues sufficient only to pay the interest on the Bank's loan. By the time of trial, the Bank and the FDIC had received over $65 million in interest from Grace, generated by Grace's expenditure of another $64 million in

acquisition, drilling and operating costs. Grace, on the other hand, has yet to receive a penny from the property.

Proceedings in the District Court

On June 14, 1984, the Bank sued Grace for federal and state securities act fraud and common law fraud, alleging that in obtaining the loan Grace had failed to disclose that a well then being drilled on one of the purchased fields was dry, or non-commercial.[2] In October 1984, after Continental assigned this and numerous other loans to the FDIC as part of the government's bail-out of the troubled bank, the FDIC was substituted as plaintiff (App. 2A). Thereafter, the FDIC filed an amended complaint in its own name which predicated jurisdiction upon, *inter alia*, 28 U.S.C. § 1345 ("United States as plaintiff") and the Federal Deposit Insurance Act, 12 U.S.C. § 1819 (App. 2A).

On September 17, 1987, the district court dismissed all federal and state securities law claims but rejected Grace's motion for summary judgment on the remaining claim of common law fraud (App. 40A, *et seq.*). There followed a four-week trial. Throughout the trial and in its summation, the FDIC set its sights on rescission and repayment of the $75,000,000 loan in full in addition to punitive damages. As the court of appeals found, through no fault of petitioners the FDIC chose to put on no expert testimony or other evidence from which its damages could be computed (App. 14A).

On October 20, 1987, the jury returned a general verdict against Grace in the amount of $100,000,000, comprised of $25,000,000 in compensatory damages and $75,000,000 in punitive damages (App. 2A). Grace's post-trial motions for j.n.o.v. and other relief were denied, except for a conditional remittitur of the punitive damage award to $25,000,000, which the FDIC promptly accepted (App. 55A-57A). The district court held that the Eighth Amendment was "inapplicable" to the FDIC's puni-

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2 This, despite the uncontroverted fact that in 1980 the same field had been "all assumed Dry!" by Continental for the purposes of its internal analysis in assessing whether or not to make the loan (App. 3A).

tive damage award (App. 33A), and that there was no "constitutional infirmity" in giving the jury standardless discretion to impose it (App. 36A). Judgment was docketed on July 5, 1988 for $25,000,000 in compensatory damages plus $25,000,000 in punitive damages.

Proceedings in the Court of Appeals

Grace appealed from the denials of the summary judgment and post-trial motions, and from the final judgment; the FDIC did not cross-appeal. The court of appeals, in a panel decision filed June 21, 1989 (per Posner, J.), affirmed the district court with respect to liability, but vacated the damage judgment in its entirety because the FDIC had submitted "no evidence" to support its damage claim or to permit any calculation of damages (App. 14A). The court found that "[t]his is not a case where the defendant's wrongful conduct made it difficult to establish the plaintiff's damages" (App. 14A), and that "the jury was allowed to pick a figure out of the air" and return "a multimillion dollar damages verdict that is pure guesswork" (App. 14A). On that basis, it ordered a new trial on damages but not liability. Having rejected Grace's Fifth, Eighth and Fourteenth Amendment arguments concerning punitive damages, the court of appeals also ordered a new trial on punitive damages, "related as they are to compensatory damages" (App. 15A).

On July 5, 1989, Grace filed a timely petition for rehearing and suggestion for rehearing *en banc*, arguing, *inter alia*, that the court's direction of a partial retrial (rather than an award of nominal damages only or a retrial of all issues), was constitutionally impermissible under the Seventh Amendment and the rule of *Gasoline Products Co.* v. *Champlin Refining Co.*, 283 U.S. 494 (1931). Grace also reiterated the Fifth, Eighth and Fourteenth Amendment constraints on the *government's* capacity to recover punitive damages. The FDIC did not cross-petition but submitted a response as requested by the court of appeals (*see* Fed. R. App. P. 35). The court, in a *per curiam* order, denied Grace's petition on September 11, 1989 (App. 54A).

REASONS FOR GRANTING THE WRIT

I.

This Case Presents Important and Unresolved Issues Concerning Awards of Punitive Damages to Government Instrumentalities

Until the decisions below, no court had ever held the FDIC authorized to recover common law punitive damages—an authority not granted it by Congress. Although this lack of authority was repeatedly raised by Grace, the decisions below failed even to address it. If not reviewed, this result can be expected to spawn much mischief in this era of considerable litigation over failed financial institutions.[3]

This petition also presents two other important questions concerning the constitutionality of punitive damages that have eluded the Court's review in recent Terms. The first, expressly left open in *Browning-Ferris Industries, Inc.* v. *Kelco Disposal, Inc.*, ____ U.S. ____, 109 S. Ct. 2909 (1989), is whether a *government* instrumentality may, consistent with the Eighth Amendment's prohibition of excessive fines, recover virtually unlimited punitive damages in a common law civil litigation. The second is whether due process permits giving a jury standardless discretion to award huge punitive damages (assessed at $75 million by the jury in the initial trial in this action). That question eluded the Court's review (because it had not been raised in the lower courts) in both *Browning-Ferris*, *supra*, 109 S. Ct. at 2921, and *Bankers Life and Casualty Co.* v. *Crenshaw*, 108 S. Ct. 1645, 1649 (1988) (to be officially reported at 486 U.S. 71).

Here, petitioners' Fifth, Eighth and Fourteenth Amendment constitutional objections were fully preserved in a case which comes up through the federal courts, involves a plaintiff which is an agency of the federal government, and clearly presents the

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3 According to its most recent Annual Report, the FDIC had "15,168 cases on the litigation docket at year-end 1988". FDIC, *1988 Annual Report to Congress* at 20 (Aug. 29, 1989).

constitutional issues. Accordingly, we submit that this case is particularly appropriate for review.

A. Congress Has Not Authorized the FDIC To Collect Common Law Punitive Damages

The FDIC is one of a host of "corporations discharging governmental functions" created by Congress. *Keifer & Keifer* v. *Reconstruction Finance Corp.*, 306 U.S. 381, 390 n.3 (1939). *See also First Agricultural National Bank* v. *State Tax Commission*, 392 U.S. 339, 362 (1968) (Marshall, J., dissenting, joined by Harlan, J. and Stewart, J.) (characterizing the FDIC as a "federal instrumentalit[y]"). As amended August 9, 1989, section 9 of the Federal Deposit Insurance Act, 12 U.S.C. § 1819(b)(1), provides that the FDIC "shall be an agency of the United States for purposes of section 1345 of title 28", which is the same section invoked by the FDIC's jurisdictional allegations here (App. 2A). *See* Pub. L. No. 101-73, 103 Stat. 216 (Aug. 9, 1989).[4]

As a creature of statute, the FDIC has only such authority as Congress has seen fit to give it. *See* 12 U.S.C. § 1811 (the FDIC "shall have the powers hereinafter granted"). And, as stated in *FDIC* v. *Abraham*, 439 F. Supp. 1150, 1153 n.3 (E.D. La. 1977):

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4 It is beyond dispute that the FDIC is an agency of the federal government. Each year the FDIC is required to submit an Annual Report to Congress, 12 U.S.C. § 1827(a), and is audited by the United States General Accounting Office, 12 U.S.C. § 1827(d). Its rules are published in the Code of Federal Regulations. 12 C.F.R. Part 300, *et seq.* (1988). Its Board of Directors consists of the Comptroller of the Currency, the Director of the Office of Thrift Supervision, and three other individuals appointed by the President with the advice and consent of the Senate. 12 U.S.C. § 1812(a). "The full faith and credit of the United States is pledged to the payment of any obligation issued . . . by the [FDIC]." 12 U.S.C. § 1825(d). As the Court has previously observed about a similarly governed federal corporation:

> "That the Congress chose to call it a corporation does not alter its characteristics so as to make it something other than what it actually is, an agency selected by Government to accomplish purely governmental purposes." *Cherry Cotton Mills, Inc.* v. *United States*, 327 U.S. 536, 539 (1946) (Reconstruction Finance Corporation).

> " 'The FDIC is not in business for the purpose of making money out of the failure of banks, and the power granted by [the Federal Deposit Insurance Act] may only be used for the purpose of avoiding loss.' "

When Congress has wanted to empower a government corporation to recover punitive damages, it has done so expressly and has imposed strict limitations.[5] In those limited instances in which Congress authorized the FDIC to recover civil penalties, it carefully circumscribed that authority.[6]

As one recently published treatise notes:

> "A number of federal statutes expressly provide or forbid the recovery of punitive damages. However, under other statutes, Congress has failed to state in specific terms whether or not punitive damages can be recovered. In the absence of any definitive Supreme Court decisions in this area, courts have therefore been required to determine whether to make punitive awards without the benefit of either legislative or judicially defined criteria. As a consequence, conflicting standards have been set forth, and the law in this area has become confused."

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5 *See, e.g.*, 12 U.S.C. § 1723a(e) (permitting the Federal National Mortgage Association and the Government National Mortgage Association to sue for "punitive damages . . . not exceeding $100 for each day during which such violation is committed or repeated"); 45 U.S.C. § 711(j) (permitting the United States Railway Association, a government corporation, to sue for "punitive damages . . . in an amount not to exceed $100 for each day during which such violation was committed").

6 Under the authorizations in effect at the time of the decisions below, and up until the 1989 amendments hereafter discussed, in 12 U.S.C. § 1817(a)(1) (penalty not to exceed $100 per day); 12 U.S.C. § 1817(j)(16) (civil penalty of not more than $10,000 per day); 12 U.S.C. § 1818(i)(2)(i) (civil penalty of not more than $1,000 per day); 12 U.S.C. § 1828(a) (penalty of not more than $100); 12 U.S.C. § 1828(h) (penalty of not more than $100 per day); 12 U.S.C. § 1828(j)(4)(A) (civil penalty of not more than $1,000 per day); 12 U.S.C. § 1829 (penalty not more than $100 per day).

2 L. Schlueter & K. Redden, *Punitive Damages* § 19.1, at 302 (2d ed. 1989) (footnotes omitted).

Congress has nowhere authorized the FDIC to recover unrestricted, open-ended punitive damages. Indeed, its recent massive overhaul of Title 12 in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183, *et seq.*, underscores this. There, Congress created a right to recover "civil penalties" in connection with fraud on an insured bank but provided "[t]he amount of the civil penalty shall not exceed $1,000,000", and required that "[a] civil action to recover a civil penalty under this section shall be commenced by the Attorney General", not the FDIC. *See* 12 U.S.C. § 1833a(b) and (d).[7]

B. The Excessive Fines Clause Prohibits the Awarding of Unbridled Punitive Damages to the Government

In *Browning-Ferris*, *supra*, the Court left open the question of whether the Eighth Amendment prohibition on excessive fines applies where the government itself is to be the recipient of any punitive award. *Browning-Ferris*, *supra*, 109 S. Ct. at 2920 ("[w]e think it clear . . . that the Eighth Amendment places limits on the steps a *government* may take against an individual, whether it be keeping him in prison, imposing excessive monetary sanctions, or using cruel and unusual punishments"); *id.* at 2920 n.21 ("our opinion in *Halper* implies that punitive dam-

7 The FDIC's posture here as the Bank's assignee does not in any way diminish the force of this argument. Illinois common law prohibits the assignment of all claims except those specified in the Illinois Survival Act, and "Illinois law is clear that punitive damages are not recoverable under the Survival Act," *Ballweg* v. *City of Springfield*, 114 Ill. 2d 107, 117, 499 N.E.2d 1373, 1377 (1986); *Froud* v. *Celotex Corp.*, 98 Ill. 2d 324, 333-35, 456 N.E.2d 131, 136 (1983); *Mattyasovszky* v. *West Towns Bus Co.*, 61 Ill. 2d 31, 33-34, 330 N.E.2d 509, 510 (1975); *see also In re Air Crash Disaster Near Chicago Ill. on May 25, 1979*, 644 F.2d 594, 605-06 (7th Cir.), *cert. denied*, 454 U.S. 878 (1981) (following *Mattyasovszky*). But even if (as the FDIC argued below) claims for punitive damages were assignable under federal common law, the question of the FDIC's ability to recover them would remain.

ages awarded to the *Government* in a civil action may raise Eighth Amendment concerns") (emphasis supplied).

The FDIC's closing argument urged the jury to award $100 million in punitive damages on top of the repayment of the loan in full. The "potential for governmental abuse" which was of much concern in *Browning-Ferris* (109 S. Ct. at 2914 n.3, 2916 & n.9, 2920 & n.21) is clear here and should now be addressed.[8] The precise issue left unresolved in *Browning-Ferris* has been fully presented and preserved both before the district court and the court of appeals.

C. Giving a Jury Standardless Discretion To Award Punitive Damages Violates Due Process

The Due Process Clauses of the Fifth and Fourteenth Amendments ensure that all defendants, whether in criminal or civil cases, are entitled to "fundamental fairness" in actions that may deprive them of "life, liberty, or property"; and, of course, a corporation "is entitled to due process", *Browning-Ferris, supra*, 109 S. Ct. at 2925 (O'Connor, J., concurring in part, joined by Stevens, J.).

Giving a jury "standardless discretion" to award punitive damages to any civil litigant, let alone the *government*, raises substantial concerns about Fifth and Fourteenth Amendment

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8 The excessiveness, indeed irrationality, of the initial $75 million and now-vacated $25 million punitive damages award in this case is demonstrated by comparison with the fines established by both Congress and the Illinois legislature for a criminal conviction for bank fraud. *See Browning-Ferris, supra*, 109 S. Ct. at 2934 (O'Connor, J., concurring in part, joined by Stevens, J., urging adaptation of *Solem* v. *Helm*, 463 U.S. 277 (1983) framework to punitive damages). At the time this action was tried, the maximum monetary penalty for conviction of defrauding a federally chartered bank was a $10,000 fine. 18 U.S.C. § 1344(a)(1988). The corresponding Illinois state law maximum was a $1,000 fine. Ill. Rev. Stat. ch. 38, para. 1005-9-1(a)(2). Here, the jury's verdict was 7,500 times the federally legislated maximum and 75,000 times the state legislated maximum. Even as remitted, the punitive damage award was still 2,500 and 25,000 times as large, respectively.

due process constraints. *Browning-Ferris, supra*, 109 S. Ct. at 2923 (Brennan, J., concurring, joined by Marshall, J.); *id.* at 2924 (O'Connor, J., concurring in part and dissenting in part, joined by Stevens, J.); *Bankers Life, supra*, 108 S. Ct. at 1654 (O'Connor, J., concurring in part, joined by Scalia, J.).

Here, using a modified Illinois pattern jury instruction, the trial court charged: "if you believe that justice and the public good require it, you may in addition . . . award plaintiff an amount which will serve to punish Grace and to deter others". To say the least, "guidance like this is scarcely better than no guidance at all." *Browning-Ferris, supra*, 109 S. Ct. at 2923 (Brennan, J., concurring, joined by Marshall, J.).[9]

In *Giaccio* v. *Pennsylvania*, 382 U.S. 399 (1966), the Court struck down a Pennsylvania statute that allowed a jury acquitting a defendant to assess court costs against him if it found him guilty of " 'some misconduct . . . as a result of which he should be required to pay some penalty' ". *Id.* at 404. The Court condemned the statute for "leav[ing] to the jury such broad and unlimited power in imposing costs . . . upon their own notions of what the law should be", and held the imposition of a $231 fine violative of the Due Process Clause of the Fourteenth Amendment. *Id.* at 403-04.

Unlike *Browning-Ferris, Bankers Life* and other cases, these important constitutional arguments were fully presented and preserved here.

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9 *See also Dun & Bradstreet, Inc.* v. *Greenmoss Builders, Inc.*, 472 U.S. 749, 780 n.4 (1985) (" 'the alleged deterrence achieved by punitive damages awards is likely outweighed by the costs . . . at least when the standards on which the awards are based are ill-defined' ") (Brennan, J., dissenting, joined by Stevens, J.), *quoting Smith* v. *Wade*, 461 U.S. 30, 59 (1983) (Rehnquist, J., dissenting).

II.

In the Exercise of Its Supervisory Authority, and to Prevent the Waste of Judicial Resources, This Court Should Consider and Clarify the Proper Procedure After a Trial in Which the Plaintiff Fails to Prove Damages

After noting how "easy" (App. 13A) it would have been for the FDIC to submit evidence that would have supported an award of compensatory damages, the court of appeals found that "[n]o evidence enabling such a computation to be made was presented. The jury was allowed to pick a figure out of the air . . . the FDIC had the burden of proving what it lost, and it failed to carry the burden, resulting in a multi-million dollar damages verdict that is pure guesswork" (App. 14A). Neither the trial court nor Grace did anything to impede the FDIC's proof of damages (App. 14A), nor was the FDIC's default the result of excusable neglect; on the contrary, it resulted from the FDIC's tactical decision to put all its eggs in the rescission basket, a trial strategem which the jury rejected.[10]

It is fundamental to our jurisprudence that a party is entitled to one, but only one, full and fair opportunity to prove its case. When a defendant fails to submit evidence on an essential element of its claim or defense, not because of judicial error but as a result of its own trial strategy, it must abide by that result. Under the familiar principle of equal justice under law, the same should be true of a plaintiff who fails to prove an essential element of his cause of action (in this case, damages) because his trial strategy backfires. One full and fair trial is all that this judicial system can or should afford. This prinicple is true *a fortiori* in an action for punitive damages by the government. *See United States* v. *Halper*, ____ U.S. ____, 109 S. Ct. 1892 (1989) (double jeopardy clause applies to civil sanctions to the extent they may fairly be characterized as punitive).

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10 The trial court charged the jury on the elements of rescission. In his summation, counsel for the FDIC asked for repayment of the $75 million loan in full (plus $100 million in punitive damages). The trial court provided the jury with two alternative verdict forms: one for rescission; the other for damages. The jury rejected the rescission theory.

It has forever been the law in this country that

> "where the amount of damage is susceptible of proof, proof must be offered; and if in such a case no proof of the quantum of damages is offered, recovery can be had for a nominal amount only."

1 T. Sedgwick, *Measure of Damages* § 171, at 322 (9th ed. 1912) (footnote omitted).[11] The Court held more than a century ago that a litigant who fails to prove damages is not entitled to another chance to litigate the issue; apparently, it has had no occasion to reaffirm that principle since. *Blake* v. *Robertson*, 94 U.S. 728, 734 (1876); *see also Ustrak* v. *Fairman*, 781 F.2d 573, 581 (7th Cir.), *cert. denied*, 479 U.S. 824 (1986); *In re Letterman Bros. Energy Securities Litigation*, 799 F.2d 967, 974 (5th Cir. 1986), *cert. denied*, 480 U.S. 918 (1987).

The trial below took more than 10% of the district judge's time during 1987. The retrial ordered would probably be no shorter since evidence of compensatory damages would be introduced for the first time and the punitive damage issues would go even beyond proof of the substantive tort elements. This record of "no evidence" of damages (App. 14A) presents a paradigmatic case for reminding the courts of appeals that this burdened judicial system should not permit sophisticated litigants to retry complex cases after a deliberate, inexcusable failure of proof.

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11 *See also Restatement of Torts* § 907, at 551 (1939) (" '[n]ominal damages' are a trivial sum of money awarded to a litigant who has established a cause of action but has not established that he is entitled to compensatory damages"); *Restatement (Second) of Torts* § 907 (1979); D. Dobbs, *Remedies* § 3.8, at 191 (1973) ("[nominal] damages are awarded when the plaintiff has asserted substantial damages, but has been unable to prove those damages with the required certainty"); W. Prosser and W. Keeton, *The Law of Torts* § 110, at 765 n.2 (5th ed. 1984); C. McCormick, *Law of Damages* § 23, at 91 (1935).

III.

The Decision Below Conflicts with this Court's *Gasoline Products* Rule and with Decisions of Eight Other Circuits

Assuming *arguendo* that any retrial is appropriate in this case, we submit that, consistent with the Seventh Amendment to the Constitution and the rule of *Gasoline Products Co.* v. *Champlin Refining Co.*, 283 U.S. 494 (1931), the retrial must be a retrial of the whole case.

In *Gasoline Products* the Court held that a partial retrial limited to damages "may *not* properly be resorted to unless it clearly appears that the issue to be retried is so distinct and separable from the others that a trial of it alone may be had without injustice." *Id.* at 500 (emphasis added). No such finding was, or could have been, made below because here "the question of damages . . . is so interwoven with that of liability that the former cannot be submitted to the jury independently of the latter without confusion and uncertainty, which would amount to the denial of a fair trial." *Id.*[12]

The retrial ordered here would require the new jury to decide such issues as the relative importance of the dry hole as compared with the other properties securing the loan; the extent of the parties' knowledge of the dry hole, and how much less the Bank would have loaned if it has known whatever Grace knew

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12 In *Gasoline Products* the jury returned a verdict for the plaintiff on its contract claim and a smaller verdict for the defendant on its counterclaim for damages under a different contract—leaving a balance in favor of the plaintiff for which the district court entered judgment. The First Circuit held that an incorrect measure of damages was applied on the counterclaim, and directed a new trial limited to counterclaim damages only. This Court reversed because the issue of liability was not "distinct and separable" from the issue of damages. 283 U.S. at 499-500. A new trial was required on *all* counterclaim issues because facts material to liability (such as the terms of the contract and details as to what performance would be deemed adequate) would have to be decided by the new jury in assessing damages. In such circumstances, the second jury would either be free to reach a verdict contrary to the liability verdict that had not been set aside or would be so restricted as to deny a fair trial to the defending party.

about it (App. 14A). These all overlap the issues of material misrepresentation, scienter and reliance that were tried to the first jury. Moreover, since the new jury is to assess punitive damages, it will necessarily have to consider all the facts giving rise to the fraud charges and determine " 'the motive, purpose and condition of mind and heart of the wrongdoer and the circumstances and manner of his doing the wrong.' " *Allabastro* v. *Cummins*, 90 Ill. App. 3d 394, 400, 413 N.E.2d 86, 90 (1980). In other words, to assess punitive damages the new jury will have to re-decide the fraud case and weigh both aggravating and ameliorating circumstances beyond mere fraud. *West* v. *Western Casualty & Surety Co.*, 846 F.2d 387, 398 (7th Cir. 1988) (applying Illinois law).[13]

By remanding this case for a retrial of damages only the court of appeals not only ignored the rule of *Gasoline Products* but also created a conflict with long-standing precedent from eight other courts of appeals.

The First, Second, Third, Fourth, Fifth, Eighth, Ninth and Tenth Circuits have all held that when damage and liability issues are intertwined, the Seventh Amendment requires that liability be retried as well as damages in order to safeguard the defendant's right to a fair trial. *See McDonald* v. *Johnson & Johnson*, 722 F.2d 1370, 1388 (8th Cir.), *cert. denied*, 469 U.S. 870 (1984) (upon a petition for rehearing, the court modified its previous remand for trial on punitive damages only, holding it had "severed issues that are effectively intertwined" because "the issue of punitive damages was so interwoven with the substantive merits of the fraud count"); *Fury Imports, Inc.* v.

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13 *See also National Bank* v. *Norfolk & Western Ry.*, 73 Ill. 2d 160, 174, 383 N.E.2d 919, 924 (1978) ("punitive recovery addresses . . . the nature and gravity of a defendant's wrongful and willful act"); *accord Bucher* v. *Krause*, 200 F.2d 576, 587 (7th Cir. 1952), *cert. denied*, 345 U.S. 997 (1953); *Johnson* v. *Bowers*, 151 F. Supp. 777, 779-80 (E.D. Ill. 1957). *See Restatement (Second) of Torts* § 908, comment (e) (1979) ("[i]n determining the amount of punitive damages . . . the trier of fact can properly consider not merely the act itself but all the circumstances including the motives of the wrongdoer, the relations between the parties and the provocation or want of provocation for the act").

Shakespeare Co., 554 F.2d 1376, 1389 (5th Cir. 1977) ("an award of punitive damages should rest on the jury's assessment of all the evidence in the case. Hence, the issue of punitive damages is so intertwined with the other issues that it should be retried with them"); *Simone* v. *Golden Nugget Hotel and Casino*, 844 F.2d 1031, 1041 (3d Cir. 1988) ("[t]he issues of liability and damages are interwoven warp and woof on this record"); *Smythe Sales, Inc.* v. *Petroleum Heat & Power Co.*, 141 F.2d 41, 45 (3d Cir. 1944) ("the determination of the amount of punitive damages, if any, to be awarded . . . cannot appropriately take place except in connection with the consideration by the jury of the whole question of the defendant's liability and of all the circumstances which it is asserted give rise to that liability"). *See also Payton* v. *Abbott Labs*, 780 F.2d 147, 154-55 (1st Cir. 1985); *Aldrich* v. *Thomson McKinnon Securities, Inc.*, 756 F.2d 243, 249 (2d Cir. 1985); *Malandris* v. *Merrill Lynch, Pierce, Fenner & Smith Inc.*, 703 F.2d 1152, 1178 (10th Cir.) (*en banc*), *cert. denied*, 464 U.S. 824 (1983); *United Air Lines, Inc.* v. *Wiener*, 286 F.2d 302 (9th Cir.), *cert. denied*, 366 U.S. 924 (1961).[14]

In *Atlantic Coast Line R.R.* v. *Bennett*, 251 F.2d 934, 939 (4th Cir. 1958), the court of appeals refused to order a retrial limited to punitive damages because:

> "In the instant case we are unable to say that the new trial can be restricted to the single issue without injustice to the defendant, since the evidence relating to wilful misconduct is so inextricably tied up with that relating to primary negligence that a fair trial upon either issue requires a trial of both issues together. Moreover, it is by no means certain that a jury which has a free hand to find a verdict on the whole case will reach the same conclusion as one which has

14 An exception to this general rule has been recognized in cases where a jury has returned a sufficiently detailed special verdict so that a second jury knows precisely what was decided and does not have to make the same fact-finding as the first jury in awarding damages. *Norfolk Southern R.R.* v. *Ferebee*, 238 U.S. 269 (1915). This exception is not applicable here because the first jury returned only a general verdict so that the second jury has no findings of fact upon which to base an award of either compensatory or punitive damages.

been given a binding instruction on one particular element of the damages."

The inescapable reality that issues of liability are inextricably intertwined with proof of damages at the retrial directed by the court of appeals was openly admitted by counsel for the FDIC in a status conference held December 5, 1989 before the district court. The court asked counsel for the FDIC, "[h]ow long do you expect the trial to take?" Counsel responded:

> "In order to really show a jury why we are entitled to substantial punitive damages, we will have to go into some of the aggravating circumstances . . . what the Court found to be willfull circumstances of the loan and its negotiation. . . . I would expect realistically knowing how trials can just stretch more than you think they should ten days at least, a couple of weeks of trial." (App. 72A).

The rule set out by the Court fifty-eight years ago in *Gasoline Products* should apply without reservation to retrials involving common law fraud and prayers for punitive damages. The decision below ignores that rule and conflicts with decisions from eight other circuits.

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to review the decision of the United States Court of Appeals for the Seventh Circuit.

Dated: New York, New York
December 8, 1989

Respectfully submitted,

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APPENDIX

IN THE UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

No. 88-2275

FEDERAL DEPOSIT INSURANCE CORPORATION,

Plaintiff-Appellee,

—v.—

W.R. GRACE & CO. and GRACE PETROLEUM CORPORATION,

Defendants-Appellants.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION.
No. 84 C 5031—HARRY D. LEINENWEBER, *JUDGE.*

Argued February 23, 1989—Decided June 21, 1989

Before BAUER, *Chief Judge*, and POSNER and RIPPLE, *Circuit Judges.*

POSNER, *Circuit Judge.* This case began as a diversity suit (governed, the parties agree, by Illinois law) for fraud. The plaintiff was Continental Illinois National Bank, the defendants W.R. Grace & Co. and its wholly owned subsidiary, Grace Petroleum Corporation. The parties treat the two Graces as interchangeable; so shall we. The appeal presents questions of contract law and damages.

Continental had made a $75 million nonrecourse production payment loan to Grace to enable it to develop some natural-gas fields in Mississippi, and when one of the fields turned out to be

worthless Continental contended that Grace had induced the loan by fraud. Shortly after filing the suit Continental assigned the loan to the Federal Deposit Insurance Corporation, which had bailed out the failing Continental. The FDIC substituted itself for Continental as the plaintiff and switched the statutory basis of federal jurisdiction from 28 U.S.C. § 1332 (diversity) to 28 U.S.C. § 1345 (suits "commenced by" the United States), 12 U.S.C. § 1819 (the Federal Deposit Insurance Corporation Act), and 28 U.S.C. § 1331 (federal-question jurisdiction). After a four-week trial a jury awarded the FDIC $25 million in compensatory damages and $75 million in punitive damages. The district judge cut the award of punitive damages to $25 million.

Grace appeals, raising a variety of grounds of which the first and least is that there is no federal jurisdiction. The jurisdiction of suits by and against the FDIC is specified in section 1819 Fourth of the Banking Code, which provides that all suits to which the FDIC is a party shall be deemed to arise under the laws of the United States (thus bringing section 1331, the federal-question statute, into play), unless the FDIC is a party "in its capacity as receiver of a State bank." Since Continental is a national bank rather than a state bank, this exception to federal jurisdiction would not apply even if the FDIC had been suing as a receiver, which it was not; an assignee is not a receiver. See, e.g., *FDIC v. Braemoor Associates*, 686 F.2d 550, 552-53 (7th Cir. 1982); *FDIC v. Elefant*, 790 F.2d 661, 665 (7th Cir. 1986) (dictum). *Elefant* hints that substituting the FDIC for a state bank in a diversity suit that had already been filed would not destroy diversity jurisdiction, see *id.* at 666, unless the assignment was for the purpose of conferring federal jurisdiction where it would not otherwise exist. See 28 U.S.C. § 1359; *Hartford Accident & Indemnity Co. v. Sullivan*, 846 F.2d 377, 382 (7th Cir. 1988). Jurisdiction normally depends on the facts when the case was brought rather than on what happens later. But no more than in *Elefant* need we resolve the issue in order to confirm the district court's jurisdiction; Continental was not a state bank.

Grace has not shown any error in the district judge's jury instructions or evidentiary rulings, so we take the facts to be as

favorable to the FDIC as a reasonable jury could have found them to be. In 1980 Grace decided to bid for a 50 percent interest in three natural-gas fields owned by a subsidiary of Centex Corporation—the Thomasville, East Thomasville, and Southwest Piney Woods fields, all in the same part of Mississippi. Four wells had already been drilled in the first two fields and three were planned for southwest Piney Woods, of which one had been drilled but was not yet producing. To finance the purchase, Grace went to its long-time banker, Continental, for a $75 million "nonrecourse production payments loan"—a loan repayable only out of the revenues from the gas fields and not out of Grace's other assets. If the fields proved to be nonproductive, the loan would not be repaid and Continental would have no remedy for the default.

Officers of Grace showed Continental a reserve report prepared by an independent engineering firm. The report showed Southwest Piney Woods with 42 percent of the total gas reserves in the fields, although none of the proven reserves because no producing wells had been drilled yet in that field. A petroleum engineer employed by Continental reviewed the reserve report and concluded that the proven reserves in the other two fields—all he considered—had a loan value of $75 million. This was exactly equal to the loan that Grace was seeking and so left no margin for error. Next to the Southwest Piney Woods estimates the engineer wrote, "all assumed Dry!" Apparently this was his way of saying that in order to be ultraconservative in his evaluation he had ignored Southwest Piney Woods because it had no producing wells as yet. (In other words, the emphasis falls on the word "assumed.") Despite his evaluation of the Thomasville and East Thomasville fields, he told his boss that he was uncomfortable about the loan, but his boss reassured him by pointing out that the Southwest Piney Woods field could be pledged to repay the loan too, and this would provide insurance in case the Thomasville fields turned out to be less productive than expected or the price of gas fell. Consistent with this assurance, when Grace asked Continental to exclude Southwest Piney Woods from the properties dedicated to the repayment of the loan Continental refused.

On March 14, 1980, Continental wrote Grace that it was "pleased to commit to provide $75,000,000 in a production payment loan for the benefit of W.R. Grace & Co. The terms of the loan are summarized below." Provisions follow regarding interest rate (prime plus one percent), balances, maturity (December 31, 1987), security, etc., followed by the statement, "This commitment is, of course, subject to satisfactory documentation." Continental followed up with another letter to Grace on April 1, setting forth in five single-spaced pages "the principal terms and conditions for the financing" and stating at the end that "the above discussion does not constitute an exhaustive list of all the terms and conditions of the financing, but does cover those items of major importance." A virtually identical letter, differing only in being slightly longer, was sent on April 7. The final loan agreement, in which satisfactory final loan documentation is made a condition precedent to Continental's duty to perform, was signed on July 1, and disbursal of the $75 million to Grace followed shortly.

Centex had accepted Graces's $87 million bid for the Mississippi properties early in April, and the parties to that deal had agreed to close on May 23. On May 8, Grace, which pursuant to its still-executory contract with Centex was receiving frequent reports on the progress of the gas-exploration activities in the properties, learned that "Pursue Ridgeway," the well that had been drilled in the Southwest Piney Woods field, had struck water instead of gas. This was bad enough; but by May 18 Grace had discovered that the field would produce no gas, from any well. Grace was horrified. It had valued Pursue Ridgeway at $15.5 million even though the well had not yet started producing any gas. This was 17.1 percent of the entire deal. The well, along with the rest of the field, was now revealed to be worthless. Grace tried to back out of the deal with Centex, but when Centex threatened to sue, Grace decided to go ahead with the deal, which closed on May 27 with a covenant allowing Grace to sue Centex.

The next day Centex issued a press release announcing the sale to Grace and mentioning in passing that Pursue Ridgeway was "non-commercial." A news service to which Continental subscribed carried the release, but no one at Continental con-

cerned with the Grace loan noticed it. Although Grace had issued its own press release on April 22 announcing the signing of the contract with Centex to buy the Mississippi properties, it issued no press release announcing the actual purchase. And it did not tell Continental about the problem with the Southwest Piney Woods field until, three *years* after the loan was closed, it sent Continental a copy of the complaint it had filed against Centex, alleging that Centex had defrauded Grace by failing to disclose the water problem in Southwest Piney Woods. That suit was later settled for $13 million. The present suit was filed in 1984 and came to trial in 1987, at which time the balance of the $75 million loan, consisting both of principal and of unpaid interest, exceeded $76 million, even though the loan was due to be repaid in only three months. The Thomasville fields were and are productive, but gas prices had tumbled, and the volume of production was not high enough to generate revenues sufficient to repay the loan—which to this day has not been repaid.

Several points raised by Grace are shallow:

1. The fact that Continental may have been deficient in alertness in failing to notice the item in the press release about Pursue Ridgeway might be relevant if this were a suit for negligence, but it is a suit for deliberate fraud, and contributory negligence is not a defense to an intentional tort. See, e.g., *Tan v. Boyke*, 156 Ill. App. 3d 49, 57, 508 N.E.2d 390, 395 (1987); *Carter v. Mueller*, 120 Ill. App. 3d 314, 319-20, 457 N.E.2d 1335, 1340 (1983); *Mother Earth, Ltd. v. Strawberry Camel, Ltd.*, 72 Ill. App. 3d 37, 51-52, 390 N.E.2d 393, 405-06 (1979); *General Motors Acceptance Corp. v. Central National Bank*, 773 F.2d 771, 782 (7th Cir. 1985) (construing Illinois law); *Cenco, Inc. v. Seidman & Seidman*, 686 F.2d 449, 454 (7th Cir. 1982) (same); *Teamsters Local 282 Pension Trust Fund v. Angelos*, 762 F.2d 522, 527-28 (7th Cir. 1985); Prosser and Keeton on the Law of Torts 462 (5th ed. 1984).

2. That Continental's petroleum engineer, in assessing the loan value of the three fields, assumed the Southwest Piney Woods field to be nonproducing does not prove that the fraud was immaterial. Continental regarded the Southwest Piney Woods field as an important back-up to the Thomasville fields.

The fact that this was a nonrecourse loan made Grace's failure to disclose the fate of that field particularly significant. Continental could not look to Grace for repayment of the loan but only to the revenues generated by the gas fields themselves, revenues dependent on production as well as on the price of gas. *Any* diminution in that revenue potential was ominous. Grace's own reaction when it heard that the Southwest Piney Woods field was worthless bears eloquent witness to the perceived value of that field.

3. Grace's complaints about the jury instructions, the admission of certain evidence, and the sufficiency of the evidence to demonstrate its intention to conceal material information from Continental have no merit.

The difficult question on liability is whether Grace was required to volunteer to Continental, before the loan closed, the bad news about the Southwest Piney Woods field. An omission can of course be actionable as a fraud. See, e.g., *Tan v. Boyke*, *supra*, 156 Ill. App. 3d at 54, 508 N.E.2d at 393; *Chapman v. Hosek*, 131 Ill. App. 3d 180, 186-88, 475 N.E.2d 593, 598-99 (1985); *Central States Joint Board v. Continental Assurance Co.*, 117 Ill. App. 3d 600, 604, 453 N.E.2d 932, 935 (1983); *Allensworth v. Ben Franklin Savings & Loan Ass'n*, 71 Ill. App. 3d 1041, 389 N.E.2d 684 (1979). But not *every* failure by a seller (or borrower, or employee, etc.) to disclose information to the buyer (or lender, or employer, etc.) that would cause the latter to reassess the deal is actionable. A general duty of disclosure would turn every bargaining relationship into a fiduciary one. There would no longer be such a thing as arm's-length bargaining, and enterprise and commerce would be impeded. The seller who deals at arm's length is entitled to "take advantage" of the buyer at least to the extent of exploiting information and expertise that the seller expended substantial resources of time or money on obtaining—otherwise what incentive would there by to incur such costs? See *Teamsters Local 282 Pension Trust Fund v. Angelos*, *supra*, 762 F.2d at 528; *United States v. Dial*, 757 F.2d 163, 168 (7th Cir. 1985); Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. Legal Stud. 1 (1978). But when the seller has without substantial investment

on his part come upon material information which the buyer would find either impossible or very costly to discover himself, then the seller must disclose it—for example, must disclose that the house he is trying to sell is infested with termites. See, e.g., *Posner v. Davis*, 76 Ill. App. 3d 638, 395 N.E.2d 133 (1979) (basement flooding). The distinction between the two classes of case is illustrated by *Lenzi v. Morkin*, 103 Ill. 2d 290, 469 N.E.2d 178 (1984), where the failure to disclose an assessor's valuation was held not to be actionable, since the valuation was a matter of public record and therefore ascertainable by the buyer at reasonable cost. See also *Illinois Central Gulf R.R. v. Department of Local Government Affairs*, 169 Ill. App. 3d 683, 523 N.E.2d 1048 (1988).

The situation of the would-be lender who discovers that his collateral (or a major part of it) is worthless because of circumstances that the borrower learned without effort or expertise but that the lender could not have learned without a substantial investment of time or effort seems assimilable to that of the seller of the termite-infested house. But this we need not decide for certain, since we do not understand Grace to be contesting the issue of duty but only to be arguing that Continental had made a firm commitment by April 7 (if not earlier)—a commitment that it could not have backed out of even if Grace had come to it on May 8 and told it that the Loch Ness monster had swallowed the entire State of Mississippi so that Continental would not recoup a penny of the $75 million loan that it had not yet made but was committed to make. If the commitment was *that* firm, the fraud was immaterial. See *Jordan v. Duff & Phelps, Inc.*, 815 F.2d 429, 447 (7th Cir. 1987) (dissenting opinion), and cases cited there. If not, then we do not (to repeat) understand Grace to be arguing that it was entitled to stand mute when the time came to make the final agreement. If you go to a bank for a loan on your house, and the bank tentatively agrees to make it, and on the day before the loan papers are to be signed the house is destroyed by a flood and you don't disclose the fact at the signing, then we suppose—and, more to the point, Grace appears to concede—that you are guilty of fraud even if you made no representation that the house was still in existence. This case is less dramatic inasmuch as the security for

the loan was not rendered completely worthless by the Pursue Ridgeway disaster—but more dramatic in that the lender here, unlike the lender in the house example, could not sue the borrower if the assets pledged to repay the loan proved insufficient, because it was a nonrecourse loan.

So it is crucial to determine whether there was a commitment before May 8. The March and April letters were preliminary to a final agreement, but not necessarily on that account unenforceable. The question when a preliminary agreement is enforceable is a vexed one, as we noted recently in *Empro Mfg. Co. v. Ball-Co Mfg., Inc.*, 870 F.2d 423 (7th Cir. 1989); see also Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 Colum. L. Rev. 217, 249-63 (1987). But Illinois law is reasonably clear in making the issue one of the parties' intentions as gleaned from the agreement itself if the agreement is unambiguous and, if it is ambiguous, from all pertinent evidence. See *Anand v. Marple*, 167 Ill. App. 3d 918, 522 N.E.2d 281 (1988); *Ebert v. Dr. Scholl's Foot Comfort Shops, Inc.*, 137 Ill. App. 3d 550, 559, 484 N.E.2d 1178, 1185 (1985); *Inland Real Estate Corp. v. Christoph*, 107 Ill. App. 3d 183, 185-86, 437 N.E.2d 658, 660 (1981); *Interway, Inc. v. Alagna*, 85 Ill. app. 3d 1094, 407 N.E.2d 615 (1980). In cases where a preliminary agreement has been superseded by a final one, the parol evidence rule forbids the use in evidence of the preliminary agreement to alter the terms in the final one. See *Fidelity & Deposit Co. v. City of Sheboygan Falls*, 713 F.2d 1261, 1271 (7th Cir. 1983); *Patton v. Mid-Continent Systems, Inc.*, 841 F.2d 742, 745 (7th Cir. 1988); Farnsworth, Contracts 451 (1982). But here we have no final integrated agreement—no agreement into which any preliminary agreements would merge and disappear—so the rule is inapplicable.

With the parol evidence rule out of the way, two types of ambiguity can usefully be distinguished. One is internal ("intrinsic"), and is present when the agreement itself is unclear. The other is external ("extrinsic") and is present when, although the agreement itself is a perfectly lucid and apparently complete specimen of English prose, anyone familiar with the

real-world context of the agreement would wonder what it meant with reference to the particular question that has arisen. See, e.g., *Patton v. Mid-Continent Systems, Inc.*, *supra*, 841 F.2d at 745; *Amoco Oil Co. v. Ashcraft*, 791 F.2d 519, 521 (7th Cir. 1986). So parol and other extrinsic evidence is admissible, even in a case involving a contract with an integration clause, to demonstrate that the contract is ambiguous. See, e.g., *Stamatakis Industries, Inc. v. King*, 165 Ill. App. 3d 879, 887, 520 N.E.2d 770, 775 (1987); *Zale Construction Co. v. Hoffman*, 145 Ill. App. 3d 235, 241, 494 N.E.2d 830, 834 (1986); *UIDC Management, Inc. v. Sears Roebuck & Co.*, 141 Ill. App. 3d 227, 230, 490 N.E.2d 164, 166 (1986); *Sunstream Jet Express, Inc. v. International Air Service Co.*, 734 F.2d 1258, 1268 (7th Cir. 1984) (construing Illinois law); *Marmon Group, Inc. v. Rexnord, Inc.*, 822 F.2d 31, 34 (7th Cir. 1987) (per curiam). Admissible, that is to say, even if the contract has no intrinsic ambiguity—even if it would seem perfectly clear to a normal reader of English, although to persons knowledgeable about the circumstances in which the contract had been intended to apply the "normal" reading might be nonsense. See *Lucie v. Kleen-Leen, Inc.*, 499 F.2d 220 (7th Cir. 1974) (per curiam); *Isbrandtsen v. North Branch Corp.*, 556 A.2d 81, 83-85 (Vt. 1988); Farnsworth, *supra*, at 501. That is what it means to say that extrinsic evidence is admissible to *demonstrate* an ambiguity. There is no ambiguity on the surface of the document; the ambiguity appears only when extrinsic evidence is considered.

The Illinois cases provide firmer support for allowing extrinsic evidence when the contract is patently ambiguous than for allowing such evidence to establish that an otherwise clear contract is (to those in the know) ambiguous. See, e.g., *LaSalle National Bank v. General Mills Restaurant Group, Inc.*, 854 F.2d 1050, 1052 (7th Cir. 1988) (applying Illinois law). The Illinois Appellate Court is, as we noted in *Metalex Corp. v. Uniden Corp.*, 863 F.2d 1331, 1335-36 (7th Cir. 1988), divided on the latter question. Compare, for example, *URS Corp. v. Ash*, 101 Ill. App. 3d 229, 233-35, 427 N.E.2d 1295, 1299-1300 (1981), with *United Equitable Ins. Co. v. Reinsurance Co.*, 157 Ill. App. 3d 724, 730-31, 510 N.E.2d 914, 918-19 (1987). The Supreme Court of Illinois has not resolved the conflict.

Although *United Equitable* opines that the supreme court *did* resolve it, against allowing extrinsic evidence to demonstrate an ambiguity, in *Rakowski v. Lucente*, 104 Ill. 2d 317, 323, 472 N.E.2d 791, 794 (1984), many of the cases that allow the admission of extrinsic evidence for such purpose were decided after *Rakowski* and find that decision distinguishable.

The older view, sometimes called the "four corners" rule, which excludes extrinsic evidence if the contract is clear "on its face," is not ridiculous. (There is ancient wisdom as well as ancient prejudice.) The rule tends to cut down on the amount of litigation, in part by reducing the role of the jury; for it is the jury that interprets contracts when interpretation requires consideration of extrinsic evidence. Parties to contracts may prefer, ex ante (that is, when negotiating the contract, and therefore before an interpretive dispute has arisen), to avoid the expense and uncertainty of having a jury resolve a dispute between them, even at the cost of some inflexibility in interpretation.

We suspect that the alleged conflict within the Illinois Appellate Court is a pseudo-conflict; one straw in the wind is that the author of *United Equitable* also wrote *Zale*. Most of the modern cases in the "four corners" line stand for the unexceptionable proposition that "language in a contract is not rendered ambiguous simply because the parties do not agree upon its meaning." *Reynolds v. Coleman*, 173 Ill. App. 3d 585, 593 N.E.2d 897, 903 (1988). In *Rakowski* itself the extrinsic evidence that Lucente sought to introduce was an affidavit that "contains only his unsubstantiated assertion that he did not intend to include his right to seek contribution in the matters released." 104 Ill. 2d at 324, 472 N.E.2d at 794; see also *Forty-Eight Insulations, Inc. v. Acevedo*, 140 Ill. App. 3d 107, 113-14, 487 N.E.2d 1206, 1210 (1986). The fact that parties to a contract disagree about its meaning does not show that it is ambiguous, for if it did, then putting contracts into writing would provide parties with little or no protection. Several of the cases in the "four corners" line involve releases, and the courts stress the importance of encouraging settlements by enforcing releases according to their tenor. *Rakowski* was such a case; also *Kolar v. Ray*, 142 Ill. App. 3d 912, 492 N.E.2d 899 (1986). These cases stand for the proposition that the words of the con-

tract are not lightly to be ignored. The nature of the offer of proof to show an ambiguity is therefore critical. Although a self-serving statement, à la Lucente, that a party did not understand the contract to mean what it says (or appears to say) will not suffice, an offer to show that anyone who understood the context of the contract would realize it couldn't mean what an untutored reader would suppose it meant will.

Both forms of ambiguity, the intrinsic (or internal) and the extrinsic (or external), are present here and made the meaning of the contract a question for the jury, whose answer we can disturb only if it is unreasonable. First, the term "subject to satisfactory documentation," which was implicit in the April 1 and April 7 letters even though not recited in them, is ambiguous. It could mean just proof of the assumptions underlying the terms and conditions set forth in the letters, assumptions such as that Grace would own the Mississippi properties by the time the loan was closed. Or it could entitle Continental to insist that Grace document any material assumptions on which Continental's willingness to commit $75 million to Grace was based. On this reading, if Continental had discovered before the closing that the reserve report on which it had relied in evaluating the loan was inaccurate, it could never have required Grace to demonstrate that the loan was nevertheless as secure as Continental had originally believed. Cf. UCC § 2-609.

The external ambiguity lies in the fact that, to anyone cognizant of the commercial setting, the agreement was incomplete. It did not address a range of possible risks that might materialize between the commitment and the closing. Cf. *Fidelity & Deposit Co. v. City of Sheboygan Falls*, *supra*, 713 F.2d at 1271. For example, it would have been odd if by virtue of making a loan commitment Continental had become in effect the fire insurer of the Mississippi properties on the theory that it would have owed Grace $75 million even if the properties had been destroyed by fire between April 7 and the July closing and, given the nonrecourse feature of the loan, could not have gotten the money back. It may be that the commitment was implicitly conditioned on the circumstances of the loan remaining materially unchanged between the commitment date and the closing. This is a possible, not a necessary, interpretation. Grace may

have wanted a firmer commitment before agreeing to lay out $87 million to buy the properties from Centex. The only question for us is whether the agreement was so plainly a commitment by Continental to make a nonrecourse loan of $75 million to Grace come what may that the jury would have had to be irrational to find that Grace's failure to inform Continental about the disaster that befell the Southwest Piney Woods field was material. This we cannot say. The jury was entitled to conclude that the commitment fee (a modest one-half of one percent per annum on the unused portion of the loan, i.e., on any part of the $75 million that Grace decided *not* to take up) was to compensate Continental for agreeing to make the loan at the agreed interest rate, and other terms and conditions, *provided nothing new and material came to light between the commitment and the closing*. Perhaps the most telling piece of extrinsic evidence is Grace's own conduct in trying to conceal the bad news from Continental; it would have had no reason to do so under the interpretation of the contract that it is now pressing.

We turn to the issue of damages. Grace focuses most of its attack on the award of punitive damages, which it contends violates the excessive-fines clause of the Eighth Amendment and other provisions of the Constitution. Twenty-five million dollars is of course a large amount, but its reasonableness must be assessed in relation to the amount of injury done by the tortfeasor. The concern in recent cases dealing with the constitutionality of punitive-damages awards had centered on awards that are huge multiples of the compensatory damages, as in *Kelco Disposal, Inc. v. Browning-Ferris Industries, Inc.*, 845 F.2d 404, 410 (2d Cir.), cert. granted, 109 S. Ct. 527 (1988) (argued before the Supreme Court on April 18), where the punitive damages awards were more than 100 times greater than the compensatory damages. Treble damages are a common form of punitive damages, and we do not understand their constitutionality to be in question. The FDIC received only double damages.

The most straightforward rationale for punitive damages, as for fines and other criminal punishments that exceed the actual injury done by (or profit obtained by) the tortfeasor or criminal, is that they are necessary to deter torts or crimes that are

concealable. Suppose the average defrauder is brought to book only half the time. To confront him with a sanction that will make fraud worthless to him and thus deter him, it is necessary that when he is caught he be made to pay twice as much as his profits. In such a case double damages would certainly not be problematic. Fraud is a concealable tort, and indeed concealment was the essence of Grace's fraud. Only after Grace thought it was home free—in fact three years after it thought it was home free—did it reveal the fraud by sending Continental a copy of the complaint it had filed charging Centex with fraud.

Concealment is not the only rationale for punitive damages, although no other one is necessary to establish the propriety of an award of punitive damages in this case. Another rationale is that punitive damages provide surer deterrence than actual damages of conduct that we very much want to deter because it is highly anti-social. Fraud, a form of intentional wrongdoing, is in that category. Under this rationale, too, the ratio of punitive to actual damages is highly pertinent. A $100 fraud might be securely deterred by a $500 penalty on top of compensatory damages, making a total of $600; a $25 million fraud would not be securely deterred by a $500 penalty, making a total of $25,000,500. The common law of Illinois authorizes substantial awards of punitive damages in cases of fraud. See *West v. Western Casualty & Surety Co.*, 846 F.2d 387, 398-401 (7th Cir. 1988). The award here was excessive neither by Illinois nor by federal constitutional standards.

The problem is with the award of *compensatory* damages. We have railed repeatedly against the extraordinary casualness that otherwise proficient trial lawyers display at the remedy stage in commercial litigation, See *Patton v. Mid-Continent Systems, Inc., supra*, 841 F.2d at 748 (collecting cases). All their energies seem to be used up in proving (or disproving) liability. This case is no exception despite the huge stakes. It would have been easy to estimate the present value of the loan to Grace at the time of trial, to add the interest that Continental had already received on the loan, and to subtract the sum from the principal and interest that Continental would have obtained from an alternative use of the $75 million that it disbursed on the loan. For that is the measure of what Continental lost as a

result of the fraud. One alternative, of course, is that Continental would have made a smaller loan to Grace, and placed the difference elsewhere; then the experience of the sum of these hypothetical loans, compared to the experience of the actual loan, would provide the measure of Continental's loss.

Suppose hypothetically that at the time of trial, the present value of the $75 million loan that Continental made to Grace was $30 million (representing a heavy discount from the face amount of the loan, in recognition of the unlikelihood that it will actually be repaid), and Continental had already received $65 million in interest. Then the total benefit to Continental from the loan (ignoring as we shall throughout this example, for simplicity's sake, adjustment necessary to reflect changes in the value of the dollar due to inflation) would be $95 million. Suppose further that if Grace had disclosed the Pursue Ridgeway disaster to Continental, then, instead of making the $75 million nonrecourse loan to Grace, Continental would have placed the $75 million in a loan or loans (perhaps including a smaller loan to Grace) that would have yielded Continental a benefit to the date of trial of $130 million. Then its damages would be $35 million ($130 million minus $95 million).

No evidence enabling such a computation to be made was presented. The jury was allowed to pick a figure out of the air after hearing testimony that Grace's own projections of price and production from the producing fields showed that the loan would probably never be repaid. The underlying figures were not placed in evidence. Although Grace can be faulted for having failed to offer its own evidence of damages—a fault we have noted in recent cases, see, e.g., *Lancaster v. Norfolk & Western Ry.*, 773 F.2d 807, 823 (7th Cir. 1985); see also *Wallace Motor Sales, Inc. v. American Motor Sales Corp.*, 780 F.2d 1049, 1062 (1st Cir. 1985), and cases cited there—the FDIC had the burden of proving what it lost, and it failed to carry the burden, resulting in a multi-million dollar damages verdict that is pure guesswork. This is not a case where the defendant's wrongful conduct made it difficult to establish the plaintiff's damages, a situation where lenity in proof of damages is traditionally allowed. See, e.g., *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 266 (1946); *Bob Willow Motors, Inc. v. General*

Motors Corp., 872 F.2d 788, 799 (7th Cir. 1989); *Jay Edwards, Inc. v. New England Toyota Distributor, Inc.*, 708 F.2d 814, 821 (1st Cir. 1983).

Grace is entitled to a new trial, though one limited to damages. The amount of punitive damages, related as they are to compensatory damages, will have to be redetermined as well in the new trial that we are ordering. We could take the position that the first trial fixed the ratio of punitive to compensatory damages as one to one, so that whatever the next award of compensatory damages is it will just have to be doubled to yield the final judgment (before interest). But proportionality to actual damages is not the only consideration in determining how large the award of punitive damages should be, so the ratio will have to be redetermined in the new trial that we are ordering on damages.

The judgment is affirmed in part and reversed in part, and the case remanded for a new trial limited to damages. There shall be no award of costs in this court.

AFFIRMED IN PART, REVERSED IN PART AND REMANDED WITH DIRECTIONS.

A true Copy:
Teste: /s/

Clerk of the United States Court of Appeals for the Seventh Circuit

Name of Assigned Judge or Magistrate	HARRY D. LEINENWEBER
Case Number	84 C 5031
Date	June 6, 1988
Case Title	FEDERAL DEPOSIT INSURANCE CORPORATION VS. W. R. GRACE & CO., ET AL

* * *

(1) ☒ Judgment is entered as follows: (2) ☐ [Other docket entry:]

Grace's motion for judgment notwithstanding the verdict is denied. Grace's motion for a new trial on all issues is denied. Grace's alternative motion for a remittitur is granted and a new trial on the issue of damages will be granted unless the FDIC accepts the remittitur to the sum of Twenty-five million dollars. ENTER MEMORANDUM OPINION AND ORDER

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* For purpose of printing portions of the form minute order of the United States District Court, Northern District of Illinois, Eastern Division have been omitted.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

Filed June 3, 1988

Judge Harry D. Leinenweber
U.S. District Court

FEDERAL DEPOSIT INSURANCE CORPORATION, a federal corporation,	x	
Plaintiff,	x	NO. 84 C 5031
v.	x	
W. R. GRACE & COMPANY, et al	x	JUDGE LEINENWEBER
Defendants.	x	

MEMORANDUM OPINION AND ORDER

On October 20, 1987 the jury returned a verdict in favor of plaintiff, Federal Deposit Insurance Corporation ("FDIC"), and against defendants, W.R. Grace & Company, et al (collectively referred to as "Grace"), setting compensatory damages in the sum of twenty-five million dollars and punitive damages in the sum of seventy-five million dollars. On the same date the court entered judgment in favor of the FDIC, which judgments were docketed on October 22, 1987. Grace has now filed a motion for a judgment notwithstanding the verdict ("JNOV") pursuant to Rule 50(b) and in the alternative a motion pursuant to Rule 59(a)(1), Fed.R.Civ.P., to set aside the verdict of the jury and the judgment entered thereon and to grant a new trial, or in the further alternative for remittitur.

MOTION FOR JUDGMENT NOTWITHSTANDING THE VERDICT STANDARD

Initially the parties dispute whether the Illinois standard or the federal standard for entertaining a JNOV applies. Defendant argues for an Illinois standard in a case such as this which involves a state law fraud claim. The FDIC however claims that a federal standard governs the disposition of motions for JNOV in federal courts. Although neither party has discussed the difference between the Illinois standard and the federal standard, if any, it does appear that the Seventh Circuit has dictated the Illinois standard be used in diversity cases. *Ill. State Trust Co. v. Terminal R Assn. of St. Louis*, 440 F.2d 497, 500 (7th Cir. 1971). Jurisdiction here is based on diversity at least in part. Therefore the court will apply the Illinois standard as enunciated in *Pedrick v. Peoria & Eastern RR*, 37 Ill.2d 494, 510, 229 N.E.2d 504, 513-514 (1967). This standard is:

> "In our judgment verdicts ought to be directed and judgments notwithstanding the verdict entered only in those cases in which all of the evidence, when viewed in its aspect most favorable to the opponent, so overwhelmingly favors movant that no contrary verdict based on that evidence could ever stand."

Stated another way, the motion for a JNOV presents the question whether there is in the record any evidence which, standing alone and taken with all intendments most favorable to the party resisting the motion, tends to prove the material elements of the case. Only the evidence favorable to the plaintiff may be considered and if it makes out a *prima facie* case sufficient in itself for the jury the motion must be denied. 23 *ILP* "Judgments" § 152, 372. In ruling on a motion the court may not determine any controverted questions of fact or pass on the credibility of witnesses or consider any purported impeachment. Ruling on the admission and exclusion of evidence is outside the function of the motion as are considerations of jury instructions or other procedural aspects of the trial. *Id.*, pp.368-369.

MOTION FOR A NEW TRIAL STANDARD

Under Illinois law a new trial should be granted only where it appears that there has been a miscarriage of justice and that the granting of such relief will be in the interest of justice. New trials may be granted when the verdict returned by the jury appears to be the result of passion, prejudice, partiality or other improper motive and where errors and irregularities occurred during the course of the trial which might have affected the result. 28 *ILP* "New Trial" § 11, pp.580-581. On a motion for a new trial, unlike the motion for a JNOV, the court must weigh the evidence and set aside the verdict and order a new trial if the verdict is contrary to the manifest weight of the evidence. *Lynch v. Bd. of Ed. of Collinsville*, 412 N.E.2d 447, 454, 82 Ill.2d 415 (1980); *Heideman v. Kelsey*, 414 Ill. 453, 466, 111 N.E.2d 538 (1953); *Mizowek v. DeFranco*, 356 N.E.2d 32, 64 Ill.2d 303 (1976). The inquiry is whether the result reached was one which is reasonable on the facts in evidence and not whether other conclusions might also have been reached. *Lynch*, p.454.

THE ASSIGNMENT BY CONTINENTAL BANK ("BANK") TO THE FDIC

The first point relied upon by Grace is its contention that the FDIC failed to prove that the claim against Grace was assigned to it and that, even if it did prove the assignment, claims for punitive damages are not assignable (defendant's memorandum, p.13). The FDIC responds that the point was waived by Grace's failure to raise it in its motion for a directed verdict or in its statement of contested issues in the joint pretrial order. In addition the FDIC pointed out that Grace in its answer admitted the fact of the assignment while disputing the legal effect. (See Answer to Second Amended Complaint)

The legal effect of the assignment was raised and determined in pre-trial motions in this case in which Grace contended that the fraud claim was not assignable. On September 17, 1987 the court held that the fraud claim clearly was assignable to the

FDIC. The court therefore finds that the fact of, as opposed to the legal effect of, the assignment was admitted by Grace. Accordingly, it was unnecessary for the FDIC to prove the facts of the assignment at trial.

More difficult is the question of the assignability of the claim for punitive damages. The FDIC claims that the matter was waived by Grace's failure to include the point in its motion for a directed verdict. However the Seventh Circuit has held that a point that is purely legal, and not within the province of the jury, is not waived by failure to include it in the directed verdict motion. *Benson v. Allphin*, 786 F.2d 268, 274 (7th Cir. 1986) *cert. denied*, 107 S.Ct. 172. Grace's main argument is that under Illinois law punitive damages may not be recovered by an assignee of a claim for fraud. Grace contends that the claim is assignable only if it would survive the death of the injured party and that claims for punitive damages will not survive the death of the injured party under Illinois law, citing *Mattyasovszky v. West Towns Bus Co.*, 61 Ill.2d 31, 330 N.E.2d 509 (1975), and cases following, such as *In re Air Crash Disaster near Chgo., Ill.*, 644 F.2d 595, 605-606 (7th Cir.) *cert. denied*, 454 U.S. 878 (1981). However *Mattyasovszky* and the other cases cited by defendant are causes of action for torts to the person which ordinarily are not assignable under Illinois law. On the other hand causes of action for torts to property ordinarily may be assigned, 3 *ILP* "Assignments" § 15, p.439. Specifically actions for fraud or deceit survive by statute. Ill.Rev.Stat., ch.110-1/2, § 27-6. Accordingly, it has been held in Illinois that a cause of action for fraud or deceit is assignable. *Brown v. State Farm Mutual Auto Ins. Assn.*, 272 N.E.2d 261, 1 Ill.App.3d 47; *Browning v. Heritage Ins. Co.*, 338 N.E.2d 912, 33 Ill.App.3d 949. Further, Illinois follows the majority rule which holds that punitive damages are a type of relief which is part and parcel of the underlying cause of action and do not constitute an independent basis of recovery. Ghiardi & Kircher, *Punitive Damages Law & Practice* § 66.16, p.67. Therefore the case cited by both parties, *1st Fed. Savings & Loan v. Oppenheim*, 629 F.Supp. 427 (S.D.N.Y. 1986) at pp.446-447, which involved the Federal Savings and Loan Insurance Corporation, a similar agency to the FDIC, is directly on point:

> "New York permits the assignment of essentially all tort claims other than those involving recovery for personal injury (citation omitted). Once a cause of action is determined to be assignable, a punitive damage claim based upon the cause of action may also be brought by the assignee (citation omitted)."

Accordingly, the court again finds that the punitive damage claim was properly assigned to the FDIC.

WHETHER THE BANK WAS IRREVOCABLY BOUND TO MAKE THE LOAN BEFORE THE ALLEGED FRAUD

Grace's primary argument for a JNOV is its contention that Continental had issued a binding loan commitment prior to the time that Grace had learned about the "bad news."[1] The FDIC's position is that the loan commitment by its very terms was "subject to satisfactory final loan documentation" and thus was not binding.

Conditions in a contract may be precedent or subsequent depending upon the intent of the parties. 12A, *ILP* "Contracts" § 321, p.166. A determination of the intent of the parties to a contract may be a question of law or a question of fact depending upon the documents presented. *Interway, Inc. v. Alagna*, 407 N.E.2d 615, 85 Ill.App.3d 1094. As in *Alagna* the resolution of the issue depends upon the characterization of the "subject to" language in the letter. If the language is ambiguous the determination of its meaning is a question of fact for the jury but if it is unambiguous its meaning is a question of law for the court. *Id.* at 121. When used in connection with con-

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1 "Bad news", coined by plaintiff for use in this case has been adopted for use in this opinion. It refers to the discovery by Centex that the main producing zone in the Southwest Piney Woods field had a serious water level problem that made the likelihood of gas reserves in the field very low. In effect the field was "dry." This bad news was learned by a Grace employee on May 8, 1980. The initial loan "commitment" letter was given by the bank to Grace on March 14, 1980. It was amended on two subsequent occasions: April 1, 1980 and April 7, 1980.

tracts "subject to" usually indicates a condition for a party's duty of performance and suggests that mere negotiation was contemplated. *Id.* at 121. As stated in 17 Am.Jur.2d Contract, § 320 at 749:

> "Proviso in a contract creates a condition, in the absence of anything in the contract to show that such was not the intention of the parties, and the employment of such words as 'when', 'after', 'as soon as', or 'subject to' usually indicate that a promise is not to be performed except upon a condition . . ."

It would appear therefore that the best that could be said in behalf of Grace is that the commitment letter was ambiguous and the intent as to whether the commitment letter was binding as of March 14, 1980, or as amended subsequently on April 1, 1980 and again on April 7, 1980, was a question of fact that was properly left to the jury to decide. The jury was instructed by the court that "the borrower's duty to disclose ceases when a bank is obligated to lend the money." The jury obviously decided that the parties did not intend to enter into a binding commitment prior to the time that Grace learned of the bad news.

Grace also complains that the court erroneously failed to instruct the jury on the method to determine when the loan commitment was binding. However of the instructions numbered 16 through 20 submitted by Grace, the first four were preemptory as to a binding date which was a disputed fact and the last was confusing as well as preemptory. In Illinois an instruction must not assume the existence of a disputed fact. *Pioneer Hi-Bred Corn Co. v. Northern Ill. Gas Co.*, 329 N.E.2d 228, 232, 61 Ill.2d 6 (1975). In any event the instructions taken as a whole adequately covered the issue.

BURDEN OF PROOF INSTRUCTION

Grace next argues that the court's definition of the burden of proof by clear and convincing evidence as that which "leaves the mind well satisfied that the fact alleged is true" was errone-

ous because it inadequately conveyed the stricter standard to distinguish it from the "preponderance of the evidence" standard. Grace also argues that the court's definition was so vague and ambiguous so as to give the jury no parameters with which to judge the evidence.

Grace submitted two alternative instructions which defined clear and convincing evidence as "proof that leaves no reasonable doubt in the mind of the trier of fact" or, alternatively, that which is "highly probably true." However the clear and convincing evidence is a standard of proof below the criminal standard of "beyond a reasonable doubt." *Barrington Press, Inc. v. Morey*, 752 F.2d 307, 310 (7th Cir. 1985). Grace's first instruction confusingly sounds like the more rigorous criminal standard and was properly refused. The alternative of "highly probably true" is bad English and refusal was well within the court's discretion. The court finds that the burden of proof instruction was proper.

RELIANCE

Grace next argues that the FDIC failed to prove either that the bank actually relied or that it had a right to rely on the alleged misrepresentations which is an essential element of fraud, citing *Soules v. GMC*, 79 Ill.2d 282, 286, 402 N.E.2d 599 (1980). Grace's argument stems both from its contentions that the bank was committed to make the loan before Grace knew the bad news and that the bank actually knew or should have known the bad news before making the loan. Each party in its brief analyzed the facts on this point in considerable depth. Suffice to say that the issue turned to a considerable extent on the veracity of the witnesses produced by the FDIC, including Farrell and Cordell, all of whom denied knowing anything about the bad news prior to the loan closing. The court finds that there was sufficient evidence admitted to support the jury's finding of reliance on the part of the bank.

Grace next contends that the court failed to instruct the jury properly on the elements of reliance.

In this case the court instructed the jury that:

> "Continental Bank must have relied on Grace's silence and to have had a right to do so and such reliance must have been reasonable under the circumstances."

This correctly stated the law. *Redarowicz v. Ohlendorf*, 92 Ill.2d 171, 185-86 (1982); *Chgo. Title & Trust Co. v. 1st Arlington Natl. Bank*, 118 Ill.App.3d 401, 409 (1st Dist. 1983). Grace specifically argues that the court should have instructed the jury that after issuing a binding loan commitment the bank could not thereafter claim to rely on any alleged omission (defendant's instruction No. 13) and that actual knowledge of the omitted facts absolutely precludes a claim for fraud. The instructions tendered by Grace were duplicative and in some respects argumentative. It is not necessary that a court include all of the arguments that the parties may wish to make in the charge to the jury. It is the duty of the parties to argue the case while it is the duty of the court to state the law in a simple non-argumentative manner. The instruction was proper under the circumstances in this case and the refusal to give Grace's tendered instructions does not require a new trial.

MISCELLANEOUS

Next Grace argues that the court improperly excluded certain documents which dealt with the relationship between Continental Bank and Mid-America Oil & Gas Company ("Mid-America"), a subsidiary of Centex Corporation ("Centex"). However the court allowed Grace's counsel to cross-examine bank witnesses at great length about the exhibits and the relationship between Continental and Mid-America. The exhibits had little relevance and the denial of admission was not prejudicial.

Grace also complains about the exclusion of defendant's exhibit number 183. Exhibit number 183 was a hypothetical projection prepared by Grace for trial which showed what would have been recovered on the loan if assumptions of the bank's engineers had turned out to be true. This exhibit was used for demonstrative purposes, was part of Grace's argument

and therefore not evidence in the case and was properly excluded.

Grace next complains about the court preventing it from reading from depositions in its case that had already been read previously in the plaintiff's case. Rule 611 of the Fed.R.Ev. gives the court the right to exercise reasonable control over the mode and order of interrogating witnesses and the presentation of evidence to avoid needless consumption of time. The court feels that its handling of the deposition testimony was well within its discretion.

Grace complains of several other matters in addition to the foregoing, none of which was of such character that its inclusion or exclusion would have affected the result. *Lynch*, 412 N.E.2d at 454.

SCIENTER

Grace next argues that there was no proof that it acted with scienter. Both parties again provided extensive analysis of the testimony and evidence on this issue. A great number of Grace employees and officers testified in person and by deposition. The jury saw the witnesses and heard the testimony. The decision on this issue in large part hinged on the observations of the jury and therefore its finding ought not to be disturbed.

Grace next argues that the court failed to give the jury any definition of intent or scienter. However the court instructed the jury that to establish fraud by omission the FDIC had to prove that "Grace must have failed to disclose the fact with the intent to deceive." Grace instead wanted the court to define scienter by exclusion which is not only unnecessary but leads to overly long and confusing instructions. The court's instruction was adequate.

Grace next argues that the court excluded evidence of current Grace and bank business relations which it claims would show an inconsistency with the bank claims at trial. However the offer of proof made by Grace did not disclose that the parties had been involved in any other production payment loans similar to the loan involved in this lawsuit. The introduction into

evidence of the subsequent complicated business dealings between Grace and the bank would have sidetracked the trial into an examination and explanation of each dealing. This would have caused undue delay and confusion making the evidence properly excludable under Rule 403, Fed.R.Ev.

Defendant next contends that the court erred in submitting to the jury the issue of whether Grace had a duty to speak prior to the loan closing. Grace makes a two-fold argument: first, that an unconditional binding commitment eliminated the duty to speak at all, and second, the bank's failure to include a material adverse change provision in the commitment letter also eliminated the duty to speak. The former was dealt with earlier in this opinion and with respect to the latter testimony was given by both bank and Grace employees that it was clearly understood that custom required disclosure of material adverse changes regardless of the presence of a material change provision in the commitment. Therefore the duty to speak was properly submitted to the jury.

Grace next argues that the court erred in instructing on the issue of the duty to speak because the instruction included a statement that prior representations also give rise to a duty to speak. However evidence was introduced that Grace had provided the bank with reports and economic analysis prior to the issuance of the commitment letters which was adequate to support the existence of the type of prior representations that would form a basis for creating a subsequent duty to speak. *McGrath v. Zenith Radio Corp.*, 651 F.2d 458, 468 (7th Cir. 1981) *cert. denied*, 454 U.S. 835.

Next Grace argues that the court's instruction on what constitutes a material fact was prejudicial error. The court instructed the jury that a fact is material if it "relates to a matter upon which the bank could be expected to have acted differently had it known the fact." Grace has a two-fold criticism: first, the instruction denigrated the significance of the fact itself by only requiring that it be related to "a matter," and second, it used the "lesser" standard "could be expected" instead of the "stricter" standard "would have" that was proposed by Grace. The instruction given by the court finds recent support in both the Seventh Circuit and the First District Appellate Court in

Barrington Press, Inc. v. Morey, 752 F.2d 307, 310 (7th Cir. 1985), and *Mother Earth, Ltd. v. Strawberry Camel, Ltd.*, 72 Ill.App.3d 37, 390 N.E.2d 393 (1st Dist. 1979). Assuming there is a difference between the two instructions, the court finds that the result of the trial did not hinge on the formulation of materiality and therefore any error was not prejudicial.

WAIVER

Grace next argues that the court erred in refusing to instruct the jury on the issue of whether the bank waived its claim for fraud. The FDIC contends that Grace failed to preserve this defense because it was not included in the pre-trial order. Grace states that the defense was preserved through the general language "latches and other equitable principles" in the pre-trial order. However the court finds that Grace did not submit evidence justifying any instruction on waiver. The rationale of the defense of waiver is that continued performance of a contract by a party after learning of the existence of fraud makes any subsequent injury self-inflicted because such injury could have been avoided by disaffirmation or rescission. *Havoco America, Ltd. v. Hilco, Inc.*, 731 F.2d 1282, 1287 (7th Cir. 1984). Here the bank loaned Grace seventy-five million dollars in 1980. Continued performance consisted mainly of accepting payments of principal and interest up to and including the time of trial. Through no stretch of the imagination can such conduct be deemed to have been injurious to the bank. Cases cited by defendant are inapposite. Therefore the instruction was properly refused.

DAMAGES

Grace argues that the FDIC failed to prove that the bank suffered any damage from defendant's conduct and that the court's instruction on damages was error. Grace first claims that the bank did not rely on any production from Southwest Piney Woods in making its loan and consequently the "bad news" was irrelevant. However the record is replete with testi-

mony by bank employees that a non-recourse loan requires ultraconservative analysis, field diversification, and "comfort level" to protect the bank from the very problems that beset it as a result of this loan. The jury heard the witnesses and arguments of counsel in discussing the testimony of the witnesses. There was ample evidence to support the jury's finding that the bank either would not have made the loan at all or would have made the loan in a substantially reduced amount had Grace not included the Southwest Piney Woods in the loan package.

The court instructed the jury as follows:

> "If you decide to award compensatory damages, then you shall award such amount of money as will reasonably and fairly compensate the plaintiff for its damages proved by the evidence to have resulted from the fraud committed by Grace. Such amounts shall be credited to the outstanding balance of the loan."

Authority for Grace's position is *Martin v. All State Ins. Co.*, 92 Ill.App.3d 829, 835, 416 N.E.2d 347 (1981). In that case the appellate court gave an instruction similar to the one given in this case to the extent that each embodied Illinois Pattern Instruction (I.P.I.) 30.01. However in addition the court in *Martin* added elements of damages, I.P.I. 30.02, 30.05, and 30.06. The defendants successfully argued that the specific elements, viz., pain and suffering, reasonable expense of medical care, and nature, extent and duration of the injury, could not have resulted from defendant's fraud which was misrepresenting the scope of an automobile insurance policy. Here the court's instruction specifically limited recoverable damages to those resulting from any fraud committed by Grace. *Martin* is not therefore applicable.

Defendant's final objection to this instruction is that it discloses the fact that any award of compensatory damages is to be credited to the outstanding balance of Grace's loan. Defendant does not dispute that the instruction accurately states the law; it objects only to telling the jury of the consequences of its verdict. No authority is cited in support of the objection nor is any argument made about any prejudice resulting. Accordingly, the court finds no error in giving the damage instruction.

Lastly, Grace argues that the twenty-five million dollar compensatory damage award was contrary to the evidence. The law requires that there be a rational connection between the evidence on damages and the verdict. *Abernathy v. Superior Hardwoods, Inc.*, 704 F.2d 963, 971 (7th Cir. 1983). In reviewing the evidence on this point the court notes that Grace sought compensatory damages of twenty-six million two hundred thousand dollars for itself from Centex as a result of the failure of the Southwest Piney Woods field (the bad news). There was some testimony that the properties were only capable of supporting a fifty million dollar loan. The payment history of the loan in question showed that a twenty-five million dollar payment on principal at this time might allow the loan to be repaid through future production revenues. In any event the court finds that there was sufficient evidence in the record to justify the jury's verdict.

PUNITIVE DAMAGES

Grace makes a multi-faceted attack on the seventy-five million dollar punitive damage award.

Grace first argues a matter that has been previously dealt with that an assignee cannot be awarded punitive damages.

Next Grace argues that the issue of punitive damages should not have been submitted to the jury. However in Illinois punitive damages are properly recoverable in a fraud action "where the false representations are wantonly and designedly made." *Laughlin v. Hopkinson*, 292 Ill.80, 126 N.E. 591 (1920); *Home Savings & Loan Assn. of Joliet v. Schneider*, 108 Ill.2d 277, 483 N.E.2d 1225, 1228 (1985). The threshold issue is one of law: whether there is sufficient evidence justifying the submission. The question is whether there is some evidence of wilful and wantonness on the part of Grace upon which the jury could base its decision. If so then it was proper to submit the issue to the jury. The court determined at trial that this threshhold had been met. The evidence justifying the submission included evidence that Grace considered itself entitled to punitive damages from Centex for essentially the same conduct with which the

FDIC charges Grace, *i.e.*, failure to disclose to Grace the serious water problem in the Southwest Piney Woods. The court continues to believe that the issue of punitive damages was properly submitted to the jury.

Grace also argues that the court erroneously instructed the jury on the issue of punitive damages.

The court gave a modified version of I.P.I. 35.01 requiring that the jury find "Grace . . . guilty not only of fraud but also of wilful and wanton conduct in addition to fraud which proximately caused injury to the plaintiff . . ." before it could award punitive damages to the FDIC. Grace claims that the instruction permitted the jury to award punitive damages if it found that Grace committed "some wilful and wanton conduct in addition to fraud" regardless of whether it was related to the fraud. However the instruction clearly states that the wilful and wanton conduct as well as the fraud must be proximately related to the injury to the bank.

Grace also argues that the court erred in giving the instruction derived from I.P.I. 14.01 defining wilful and wanton conduct. Defendant claims without citing any authority that this instruction is not applicable in a fraud action. However Illinois Supreme Court Rule 239 (Ill.Rev.Stat., ch.110(a), § 239) requires the use of an I.P.I. instruction when it is applicable in a civil case, "giving due consideration of the facts and the prevailing law." Defendant has strenuously argued that Illinois law is applicable in the state fraud claim. Accordingly, the court finds that the instruction was proper.

CONSTITUTIONALITY OF PUNITIVE DAMAGES

Lastly Grace argues that the seventy-five million dollar punitive damage award was so excessive as to be unconstitutional and amounts to a miscarriage of justice, and requires a remittitur.

The issues of constitutionality of punitive damages[2] has received much recent attention due to the increasing size and frequency of such awards and due to the pendency before the Supreme Court of *Bankers Life & Casualty Co. v. Crenshaw*, 48 C.C.H. S.Ct. Bull, p.B1948. However the hopes of receiving some guidance were dashed when the court refused to reach the issue of whether a particularly high punitive damage award ($1.6 million punitive damage award compared to a $20,000 compensatory damage award) violated the Due Process and Excessive Fines Clauses of the Constitution.[3]

Punitive or exemplary awards had their origin in the Seventeenth and Eighteenth Century when English juries began awarding large amounts of damages in certain types of cases that were unrelated to any tangible loss. These cases fell into a wide variety of legal categories but had one common attribute: they each involved acts that resulted in affronts to the honor of innocent victims and tended to provoke communal outrage. The punitive and deterrent aspects as justification for damage awards in excess of tangible harm first received judicial expression in *Wilkes v. Wood*, 98 Eng.Rep.489 (C.P. 1763).[4]

Thus damage awards had taken on a duel nature: compensation for the wrong and punishment for the defendant. This duel nature early was recognized in American courts, e.g., *McNamara v. King*, 7 Ill. (2 Gilm.) 432, 437 (1895) ("The function of punitive damages is not only to compensate the plaintiff, but to punish the defendant").

Gradually as the concept of actual harm was broadened to include intangible harm, the original compensatory function of

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2 It is generally contended that the Supreme Court gave constitutional approval to punitive damages in *Curtis Publishing Co. v. Butts*, 388 U.S. 130 (1969). However defendant there conceded that the Constitution did not bar punitive damages in civil cases and made its argument on First Amendment grounds instead.

3 On May 31, 1988 the Supreme Court declined without opinion to review eight cases in which juries awarded punitive damages against business defendants.

4 For an interesting historical discussion, see Ellis, "Fairness and Efficiency and the Law of Punitive Damages," 56 *So.Calif.L.Rev.* 55 (1982).

punitive damages was fulfilled through compensatory damages. Courts began increasingly to emphasize the penal aspect. Today most courts speak exclusively in terms of punishment and deterence, e.g., *Restatement (Second) of Torts*, § 908; *Mattyasovszky v. West Town Bus Co.*, 330 N.E.2d 509, 511, 61 Ill.2d 32; *Hazelwood*, 450 N.E.2d at 1206.

The doctrine of exemplary or punitive damages today is subject to intense criticism on both constitutional (e.g., Wheeler, "The Constitutional Case for Reforming Punitive Damages," 69 *VA.L.Rev.* 269) and economic grounds (e.g., Ellis, "Fairness and Efficiency in the Law of Punitive Damages," 56 *So.Calif. Rev.I*, 55 (1982)). In the context of separation of powers we need concern ourselves only with the former; the legislative "inattention" that allows an "inefficient" system to continue is not subject to judicial interference. Cf. C.Britell, "The Lawmakers," 65 *Colum.L.Rev.*749 (1965).

The constitutional attack usually centers around the Eighth Amendment excessive fine clause and Fourteenth Amendment due process clause. The latter however seems to be the main cannon in the arsenal of those arguing unconstitutionality and for good reason. The Eighth Amendment has generally been considered to be applicable only to criminal proceedings (*Ingraham v. Wright*, 430 U.S. 651 (1977)) and not applicable to civil penalties. For example, statutory multiple damages (e.g., RICO, Clayton Act, etc.), (*Lindsey v. Normet*, 405 U.S. 56, 78 (1972); *Rex Trailer Co. v. U.S.*, 350 U.S. 148, 151-152 (1955)), fixed and variable fines (e.g., IRS Code, OSHA, etc.); (*Helvering v. Mitchell*, 303 U.S. 391, 400-403 (1938); *Frank Irey, Jr., Inc. v. O.S.H. Review Bd.*, 519 F.2d 1200, 1203-1204 (3rd Cir. 1975) *aff'd* on other grounds sub nom; *Atlas Roofing v. O.S.H. Review Bd.*, 430 U.S. 442 (1977); *U.S. v. J.B. Williams Co.*, 498 F.2d 414, 421 (2nd Cir. 1974)); and civil forfeitures (e.g., RICO, smuggling, Tariff Act, etc.); (*One Lot Emerald Cut Stones & One Ring v. U.S.*, 409 U.S. 232, 235-237 (1972); *Helvering*, 303 U.S. at p.400), have all been recognized as enforceable in civil proceedings in spite of their comparative severity and not been subject to the procedural rules governing criminal prosecutions. The imposition of punitive damages to deter conduct cannot by any stretch of the imagination be con-

sidered to be of greater severity than the above civil procedures. Accordingly, the court finds that the Eighth Amendment excessive fine clause inapplicable to the imposition of punitive damages in a civil fraud suit.

The Fourteenth Amendment however has received considerable support in the literature for supporting the unconstitutionality of the usual procedure (that was utilized here) for the assessment of punitive damages, e.g., Wheeler, 69 *Va.L.Rev.* 269.

Generally the Fourteenth Amendment attack starts with the premise that the due process clause requires that legal procedures be consistent with fundamental fairness. *Lassiter v. Dept. of Social Services*, 452 U.S. 18, 24-25 (1981). The attack on the punitive damage procedure focuses on the alleged vagueness of standards and terms and the virtual unlimited jury discretion to award or not to award punitive damages and to establish the amount. We shall examine each of these contentions in turn.

VAGUENESS AND LACK OF STANDARDS

In this case the court instructed the jury that it could only return punitive damages if (1) defendant was guilty of fraud, (2) defendant was guilty of wilful and wanton conduct in addition to fraud, (3) both of which proximately caused injury to plaintiff, and (4) justice and the public good require the assessment of such damages. The jury was further instructed that, if so, they should select an amount which will serve to punish defendant and deter others from the commission of like offenses. The court further instructed the jury that wilful and wanton conduct was defined as:

> "A course of action which shows actual or deliberate intention to harm or which, if not intentional, shows an utter indifference or conscious disregard for the rights of the others."

It cannot be seriously argued that these instructions, as far as telling the jury when the conduct of a defendant qualifies for the imposition of punitive damages, are unconstitutionally

vague. Wilful and wanton conduct in Illinois has long been a benchmark for the imposition of liability. For example, the duty owed up until 1972 by an owner or driver of a motor vehicle to a guest passenger was not to injure him wilfully or wantonly and continues to this day to be the duty owed a hitchhiker. Ill.Rev.Stat., ch.95-1/2, § 10-201. The duty owed up until 1984 by an owner or occupier of real estate to a licensee or social guest was not to injure him wilfully or wantonly and continues to this day to be the duty owed a trespasser. Ill.Rev. Stat., ch.80, § 303; *Krantz v. Nichols*, 11 Ill.App.3d 37, 135 N.E.2d 816 (4th Dist. 1956).

JURY DISCRETION

A more difficult question of course is raised by the claim that the procedure in use in Illinois and most other states (and used in this case) fails to instruct the jury as to any standard to use in deciding a specific dollar amount to award for punitive damages. Thus a jury can in an individual case return a verdict awarding no punitive damages or, as it did in this case, award seventy-five million dollars. However it is incorrect to say that a jury has unbridled discretion to establish the size of the punitive damage award. First, the jury is instructed that it should set the award in an amount "which will serve to punish the defendant and to deter others from the commission of like offenses." Thus the jury is instructed that its verdict should be, in effect, large enough to serve as a punishment and as a deterrence. Consequently the jury is to consider the station, wealth, and activities of the defendant and of others in a position to commit similar offenses. The jury does not do this in a vacuum, it has the arguments of counsel on both sides to assist it in making these determinations. Thus a jury would know that a sizeable amount would be necessary in a case involving a defendant of the size of Grace, while on the other hand it would know that a much smaller verdict would be necessary to punish a blue collar worker.

Post facto review exercised by both the trial court and the appellate court, with the tool of the remittitur to reduce exces-

sive amounts, is another limiting factor on jury discretion.[5] It is likewise improper to say that the *de facto* review authority of the trial and appellate court is in itself unlimited. A large body of common law has developed and is developing through the reported case law and on computer research whereby meaningful standards of comparison are being created. Reviewing punitive damage awards under the special facts and circumstances of each case is really very little different than reviewing compensatory damage awards for intangible injuries. Who is to say what the proper recovery ought to be for loss of an arm, a weak lower back, or any of the myriad injuries that result from torts whether based on negligence, intentional conduct, or product defects.[6]

The purpose of the jury is to achieve a community consensus on a specific set of facts. The court purposely gives the jury vague instructions, e.g, wilful and wanton misconduct, negligence, reasonable man standard, beyond a reasonable doubt, pain and suffering, etc. Its unanimous verdict tells us what the community thinks the result should be. Occasionally, since like everything else the jury system is not perfect, an aberration occurs. There is adequate procedure currently in place to deal with such aberrations: a JNOV or a new trial. When the aberration is a verdict in an amount that shocks the judicial conscience, an additional tool has been developed: a remittitur in lieu of a new trial.

The system for punishing defendants who commit torts in a wilful and wanton manner has served us for over two hundred years, has been adopted for use in at least forty-six of the fifty states, and has not been subjected to constitutional attack until this year. No reason to date has been put forth of why a system that has been around such a long time is suddenly so fundamen-

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5 The only truly "unbridled" discretion that the jury has is to decide not to award punitive damages. Such a decision is not reviewable.

6 In Illinois the test of whether a jury verdict for compensatory damages is excessive is whether the total amount of the verdict falls within the necessary flexible limits of fair and reasonable compensation or is so large as to shock the judicial conscience. *Chapman v. Foggy*, 375 N.E.2d 865, 871, 59 Ill.App.3d 552 (5th Dist. 1978); *King v. City of Chgo.*, 384 N.E.2d 22, 25, 66 Ill.App.3d 356 (1st Dist. 1978).

tally unfair so as to deny due process. Therefore the court finds no constitutional infirmity as to the procedure for assessment of punitive damages in this case.

AMOUNT OF PUNITIVE DAMAGES

Since we have decided the constitutional question against Grace we must now turn to the amount of punitive damages assessed in this case and perform a *post facto* review to determine whether that amount is so excessive that the judicial conscience is shocked. The general accepted rule is that a trial court give great deference to the jury award and it is not to be lightly disturbed. Only in extreme cases should a trial or an appellate court interfere with the jury's determination. Ghiardi & Kircher, *Punitive Damages Law & Practice* § 18.04.

In Illinois the standard for reviewing an award is that a reduction must be made "when it is clearly excessive." *Smith v. Seibor*, 127 Ill.App.3d 950, 957, 469 N.E.2d 231 (1984); *Robeson v. Lescrenier*, 721 F.2d 1101, 1112-1114 (7th Cir. 1983); and *Hazelwood v. Ill. Central Gulf RR*, 450 N.E.2d 1199, 114 Ill.App.3d 703 (4th Dist. 1983).

The appropriate mechanism for reducing an award of punitive damages is to establish a proper award and extend to plaintiff the choice of accepting the remittitur or having a new trial on damages. *McKinnon v. City of Berwyn*, 750 F.2d 1383 (7th Cir. 1984). *Hazelwood* lists three factors for a court to consider in determining whether a punitive damage award is excessive. The first factor is the nature and enormity of the wrong (i.e., "the punishment should fit the crime";[7] the second factor is the financial status of the defendant; and the third factor is the potential liability of the defendant beyond the present litigation. The third factor applies to multiple tort cases with multiple potential plaintiffs and is not relevant here. We shall therefore look to the first two factors. It is obvious that deter-

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7 "My object all sublime—
I shall achieve in time—
to let the punishment fit the crime. . .,"
Gilbert, Mikado.

rence would not be achieved if the wealth of the defendant allowed it to absorb the award with little or no discomfort. *Hatrock v. Edw. D. Jones & Co.*, 750 F.2d 767, 772 (9th Cir. 1984) Where the wealth of the defendant is large, a large punitive damage award could well be appropriate. In the instant case at the time of judgment the jury's punitive damage award amounted to only 5.4 percent of Grace's $1.4 billion net worth and Grace is presently capable of paying the judgment.[8] Therefore the financial status of the defendant does not require a remittitur.

The court now turns to the remaining factor: the nature and enormity of the wrong. As stated in *Hazelwood*, while all acts which give rise to punitive damages are wilful and wanton, some acts are clearly more reprehensible than others and the egregiousness of the act should be reflected in the size of the award. Using this standard the award of seventy-five million dollars in punitive damages is clearly excessive and goes far beyond a fit punishment for the actions of Grace which gave rise to liability in this case. When all is said and done this case involved the purchase of gas fields by Grace with money borrowed from the bank without recourse, a risky endeavor. For a variety of reasons, including the plummeting of gas prices as interest rates soared, less than expected production from the proven gas reserves (the Thomasville wells), as well as nonproductivity of the Southwest Piney Woods gas field, the loan has not been paid off as expected. Out of prudence and caution and undoubtedly because of the possibility of the events that did occur, the bank required plenty of cushion from Grace in order to make the loan in the form and in the amount that it did. Through Grace's wilful and wanton fraudulent misrepresentation by omission the bank was induced to loan Grace the money without the cushion it thought it had. Had lady luck not intervened the deal still might have worked: the Thomasville wells might well have performed as expected; the price of gas might have gone up as many expected it would; and interest rates might have remained stable. On the other hand had Centex not found out that the Southwest Piney Woods field was dry

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8 Grace was excused from posting the normal size bond because of its ability to pay the judgment.

prior to the loan closing, and everything else had occurred as it did, the bank would have been in the same position that it currently is, but without a cause of action againt Grace. The court therefore finds that the award of seventy-five million dollars is clearly excessive and shocks the conscience.

The decision to make a remittitur in this case is relatively easy. The more difficult question of course is to establish the amount of the remittitur. Due to the size of this punitive damage award and the size of the compensatory damage award, there is little guidance available through common law court precedents. Plaintiff has suggested that treble damage awards of this size under anti-trust law are not unusual. However a mechanical rule of three times compensatory damages, which would mean a remittitur of twenty-five million dollars in this case, does not appear to be appropriate in a common law fraud case. The purpose of the treble damage provisions in anti-trust laws is to encourage private enforcement of the anti-trust laws which is felt to be of great importance to the public. It has also been established by legislative act. In cases of private fraud the interest of the general public is not of such paramount importance and has not achieved legislative attention. Tort cases also do not easily lend themselves to mathematical formulae. Many cases involve outrageous conduct and small compensatory awards. Other cases (such as this one) involve enormous compensatory awards while perhaps less reprehensible conduct.

Considering all of the facts, including the actions of Grace, the harm to the bank, the need to deter Grace and others, a reasonable amount which would punish and deter Grace would appear to be a sum in the neighborhood of twenty-five million dollars. Accordingly, the court orders a remittitur of punitive damages from seventy-five million dollars to twenty-five million dollars. If the remittitur is not accepted by the FDIC, Grace's motion for a new trial will be granted on the issue of damages.

Accordingly, Grace's motion for a JNOV is denied. Grace's motion for a new trial on all issues is denied. Grace's alternative motion for a remittitur is granted and a new trial on the issue of

damages will be granted unless the FDIC accepts the remittitur to the sum of twenty-five million dollars.

IT IS SO ORDERED.

/s/ HARRY D. LEINENWEBER

Harry D. Leinenweber, Judge
United States District Court

DATED: June 6, 1988

Name of Assigned Judge or Magistrate	HARRY D. LEINENWEBER
Case Number	84 C 5031
Date	September 17, 1987
Case Title	F.D.I.C. V. W. R. GRACE

* * *

(1) ☒ Judgment is entered as follows: (2) ☐ [Other docket entry:]

Defendants' motion for summary judgment is granted in part and denied in part. ENTER MEMORANDUM OPINION AND ORDER.

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* For purposes of printing portions of the form minute order of the United States District Court, Northern District of Illinois, Eastern Division have been omitted.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

FEDERAL DEPOSIT INSURANCE CORPORATION, a federal corporation,	x	
Plaintiff,	x	No. 84 C 5031
v.	x	
W. R. GRACE & COMPANY, a Connecticut corporation, GRACE PETROLEUM CORPORATION, a Delaware corporation, SOURGASCO II CORPORATION, a Delaware corporation,	x	JUDGE LEINENWEBER
Defendants.	x	

MEMORANDUM OPINION AND ORDER

BACKGROUND[1]

This case involves allegations of fraud in inducing a loan from the Continental Illinois National Bank ("Bank"). The Federal Deposit Insurance Corporation, as successor in interest to the Bank, brings this suit against W.R. Grace & Company ("Grace"), Grace Petroleum Corporation ("GPC") and Sourgasco II Corporation.

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1 In this order the court will only briefly summarize the facts. For any further elaboration of the facts the court will adopt the statement of facts set forth by plaintiff in its brief in opposition to the motion.

In 1980 defendant Grace, through its subsidiary GPC, secured a production payment loan for the purpose of acquiring interests in certain oil and gas properties from Centex Corporation ("Centex"). An intermediary not-for-profit organization called the Leadership Foundation ("Leadership") was established to facilitate the loan. GPC conveyed the production payment it acquired from Centex to Leadership and the Bank made a loan to Leadership which was secured by a mortgage of the production payment. Leadership subsequently executed a note and mortgage and deed in trust and assignment to the Bank. The non-recourse loan was in the amount of seventy-five million dollars and was structured so that repayment of the principal would come entirely from the production of the property. In recovering its principal the bank was to be entitled to the lesser of two amounts: the principal amount or the value of the properties' production.

The oil and gas wells have proven to be dry and plaintiff has no prospect of repayment of the principal from the production of the property. Plaintiff alleges that defendants knew that the properties had no value as gas-producing properties yet insisted on proceeding with the loan.

Plaintiff has filed an eight-count complaint alleging violations of federal securities law; violations of the state securities laws of Illinois, Texas and Oklahoma; common law fraud and conspiracy to defraud; violations of the Texas Business and Commerce Code; and breach of warranty; and has asked for imposition of a constructive trust. The cause is before the court on defendants' motion for summary judgment. For the reasons stated herein, the motion is granted in part and denied in part.

DISCUSSION

I. Federal Securities Law

In Count I of its complaint plaintiff alleges that the production payment and the seventy-five million dollar nonrecourse note transferred by Grace to the Bank each constitutes a security as defined by federal securities law and that defendants

have acted in violation of Sections 12(2) and 17(a) of the 1933 Securities Act, 15 U.S.C. §§ 77e, 77a; Section 10(b) of the 1934 Act, 15 U.S.C. § 78j; and SEC Rule 10b-5.[2] It is appropriate to consider this issue on a motion for summary judgment. *Cocklereece v. Moran*, 532 F. Supp. 519, 525 (E.D.Mo. 1982).

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2 Under the Securities Act of 1933, 15 U.S.C. § 77b(1), a security is defined as follows:

"When used in this subchapter, unless the context otherwise requires—

(1) The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilegee on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

The 1934 Act, 15 U.S.C. 78c(10) provides essentially the same definition:

"(10) The term 'security' means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a 'security'; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

A. Investment Contract

In their motion for summary judgment defendants argue, *inter alia*, that the production payment and note do not constitute securities under federal law. In the second amended complaint plaintiff uses the following language in describing the instruments as securities:

> "The production payment and the $75 million nonrecourse note transferred by Grace to the Bank each constitutes a 'security' as that term is defined under Section 2(1) of the 1933 Act, 15 U.S.C. § 77b(1), and Section 3(10) of the 1934 Act, 15 U.S.C. § 78c(10). The transaction among Grace and the Bank, and other participants in the drilling and exploration ventures relating to the Deep Gas Properties, constitutes an investment by the Bank in a common enterprise with the expectation of profits to come principally, if not solely, from the managerial efforts of others that were given full control of operations." (second amended complaint at 14)

This language suggests that plaintiff is only contending that the instruments involved are investment contracts.

> "[A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.

SEC v. Howey Co., 328 U.S. 293, 299 (1986). In order for an investment contract to exist each prong of the *Howey* test must be satisfied.

The first element of the test requires the distinction of investments from commercial transactions. *Kansas State Bank v. Citizens Bank*, 737 F.2d 1490, 1495 (8th Cir. 1984). If a bank or other commercial lender makes a loan to finance business transactions and takes a note in return, the parties could not be said

to have participated in a securities transaction. *Hussinger v. Rockford Business Credits, Inc.*, 745 F.2d 484, 493 (7th Cir. 1984). The Seventh Circuit has held that in resolving the commercial/consumer-investment issue emphasis should be placed on the economic realities of the transaction. *Emisco Industries, Inc. v. Pro's, Inc.*, 543 F.2d 38, 40 (1976). Although use of this test was restricted by the Supreme Court in *Landreth Timber Co. v. Landreth*, 105 S.Ct. 2297, 2304-05 (1985), *Landreth* leaves open this test in cases involving unusual instruments not easily characterized as securities. *Id.* at 2304. *Landreth* further points out "that the economic reality test was designed to determine whether a particular instrument is an 'investment contract.' " *Id.* at 2305. The court finds that the economic realities of the instant case indicate that the transaction was indeed a commercial loan—the Bank is in the business of making loans, the parties treated the transaction as a loan, the deal was structured as a loan and the relevant documents described it as such, the interest rate was set at a fixed percentage over the prime rate, and the impetus for the transaction apparently came from the borrower.

Accordingly, the court finds plaintiff has failed to meet the first requirement of the *Howey* test.

The second prong of the test requires that there be a common venture. With regard to this requirement the Seventh Circuit "has strictly adhered to a 'horizontal' test of common enterprise, under which multiple investors must pool their investments and receive pro rata profits." *Stenger v. R.H. Love Galleries, Inc.*, 741 F.2d 144, 146 (7th Cir. 1984). In the instant case there are no allegations of a pooling of funds or a sharing of profits with other investors and there are no facts alleged from which any such inference could be drawn. Plaintiff therefore fails to meet this element of the *Howey* test as well.[3]

Plaintiff must next show that it had a reasonable expectation of profits to be derived from the entrepreneurial or managerial

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3 Plaintiff points to *John Hopkins University v. Hutton*, 422 F.2d 1124 (4th Cir. 1970), in which a production payment was found to be an investment contract. *John Hopkins*, however, involved a pooling of investors and did not involve the investment in securities under the guise of a bank loan.

efforts of others. "Profit, however, does not mean any return beyond principal. Rather, it is profit of the type typically associated with investment. This includes "capital appreciation resulting from the development of the initial investment . . . or a participation in earnings resulting from the use of investors' funds. . . ." *United Housing Foundation, Inc. v. Forman*, 421 U.S. 852, 853 (1975); *Canadian Imperial Bank of Commerce U. Fingland*, 615 F.2d 465, 469 (7th Cir. 1980). In the instant case the bank had no prospect of capital appreciation. The most it could have expected to recover from any increase in the value of the wells was the full amount of the principal plus the stated interest. Although the argument might be made that the production payment structure of the loan constituted a participation in earnings, the extent of such "participation" by plaintiff would be limited to the principal amount, just as it would under a recourse loan. Repayment of the interest, which was stated as a fixed amount over the prime ratè, was in no way dependent on earnings resulting from the use of investors' funds but was to be repaid regardless of earnings. Therefore plaintiff has also failed the third prong of the *Howey* test.

Under theses circumstances, where plaintiff has failed to meet the *Howey* standards, the court will find that no security exists in the form of an investment contract.

B. Fractional Undivided Interest in Oil or Gas Rights

In its brief in opposition to the motion for summary judgment plaintiff first raised the argument that the production payment represents a "fractional undivided interest in oil, gas or other mineral rights" as is also included in the definition of a security. This definition is intended to include "only that form of splitting up of mineral interests which had been most utilized for speculative purposes." *S.E.C. v. Joiner Corp.*, 320 U.S. 344, 352 (1943). Such an interest arises when a lessee of mineral rights sells part[4] of his interest in the rights in order to finance

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4 "If the seller transfers the whole of what he owns, there can be no creation of a fractional undivided interest in oil and gas, and this is so even though what he sold was a fractional interest therein." *Woodward v. Wright*, 266 F.2d 108, 112 (10th Cir. 1959).

the development of the minerals. *Penturelli v. Spector, Cohen, Gadon & Rosen*, 779 F.2d 160, 165 (3rd. Cir. 1985). Fractionalized undivided working interests "give the investor rights to a percentage of the actual minerals 'worked' from the lease or the proceeds therefrom and are subject to at least part of the expense of development, operation or maintenance." *Id.* at 160.

The instant case involves the mortgage from Leadership to the Bank of its entire interest for a potentially limited period of time, that is, until repayment of the principal. It does not involve the right to a fractional share or a specific percentage of the proceeds so as to constitute that form of splitting up of mineral interests most utilized for speculative purposes. Therefore the production payment does not constitute a fractional undivided interest in the oil and gas rights.[5]

Since neither an investment contract nor a fractional undivided interest in oil and gas rights have been found to exist under federal securities law, summary judgment will be granted as to Count I.[6]

II. Illinois Securities Law

In Count II of the complaint plaintiff alleges violations of the Illinois securities laws. The definition of a security under Illinois law (Ill.Rev.Stat., ch.121-1/2, § 137.2-1) is essentially identical to that found in the federal statues. Illinois courts attempt to apply Illinois securities law consistently with federal securities law. *See, Witter v. Buchanan*, 476 N.E.2d 1123, 1132,

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5 In its brief in opposition to the motion for summary judgment (at p.46), plaintiff parenthetically indicates that the production payment may constitute evidence of indebtedness. The test of evidence of indebtedness has also been subject to the commercial/investment distinction. *Cocklereece v. Moran*, 532 F.Supp. 519, 528-29 (E.D.Mo. 1982). As has been discussed in the context of the investment contract, the court is unwilling to find that the documents underlying the commercial loan are securities.

6 Defendants also contend that plaintiff's claim under Section 12(2) of the 1933 Act is barred by the statute of limitations and that plaintiff has no private right of action under Section 17(a) of the 1933 Act. Because of the ruling on the securities issue, the court will decline to address these defenses.

132 Ill.App.3d 273 (1985). One difference, however, is that the Illinois courts have permitted vertical commonality and do not require a pooling of investors in order for an investment contract to exist under state securities law. *Ronnett v. American Breeding Herds, Inc.*, 464 N.E.2d 1201, 1204-05; *Anderson v. Grand Bahama Development Co.*, 384 N.E.2d 981 (1979). Assuming arguendo that sufficient vertical commonality exists, the production payment still does not meet the *Howey* test in that no investment or profits have been shown.

Illinois law also contemplates that a fractional undivided interest in oil or gas rights would "entitle[ ] plaintiffs to a fractional share of the proceeds from any sale of any oil [or gas]." *Witter*, 476 N.E.2d at 1133. The court has previously discussed the inability of plaintiff to meet the requirements of fractional undivided interests in oil and gas rights under federal law. In conformance with its ruling under federal law, the court finds that the production payment and note underlying the loan do not constitute securities under Illinois law.[7] Accordingly, summary judgment is granted as to Count II.

III. Choice of Law

In Counts III, IV and VI of the complaint plaintiff alleges violations of Oklahoma and Texas law. In the motion for summary judgment defendants argue that the parties included choice of law provisions in the loan documents, designating that Illinois law should govern the contracts. Under such circumstances this circuit applies the law of the forum state to determine whether such provisions should apply. *Int'l. Administrators v. Life Ins. Co. of No. America*, 753 F.2d 133, 1377 (7th Cir. 1985). Illinois law provides that "[g]enerally, the law applicable to a contract is that which the parties intended . . . when that intent is expressed, it should be followed." *Hofeld v. Nationwide Life Ins. Co.*, 322 N.E.2d 454, 458 (1975). In the

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7 Defendants also contend that plaintiff failed to tender notice of recission and that this claim is barred by the statute of limitations. Because of its court's ruling on the securities issue, the court will decline to address these limitations issues which raise questions of fact as to when the Bank knew of the alleged fraud.

instant case the parties have expressed the intent that Illinois law should govern in the loan documents.

Plaintiff argues that where fraud is alleged a choice of law agreement contained in a fraudulently induced underlying contract should not be honored. However the court finds persuasive the rulings of other courts that have considered the enforcement of clauses where fraud has been alleged in the underlying contract. *See*, *Hoffman v. Burroughs Corp.*, 571 F. Supp. 545 (N.D. Ill. 1982). In such cases the disputed clause is unenforceable only if "the inclusion of that clause in the contract was the product of fraud or coercion." *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519 n.14 (1974). Here no fraud as to the inclusion of the clause in the contract has been alleged. Therefore the court will enforce the choice of law clauses and summary judgment will be granted as to Counts III, IV and VI, which purport to bring claims under the laws of states other than Illinois.

IV. Common Law Fraud and Conspiracy to Defraud

In Count V of the complaint plaintiff alleges common law fraud and conspiracy to defraud. In light of our previous rulings as to the securities claims, the fraud claim now constitutes the bulk of plaintiff's case. Plaintiff contends that defendants intentionally and recklessly made material omissions and misrepresentations with the intention of inducing the Bank to transfer funds to defendants. Defendants argue that it had no obligation to disclose the condition of the wells since the loan agreement was binding at the time defendants discovered the condition of the well. The court finds that there are genuine issues of material fact as to the binding nature of the loan agreements and the intent of defendants to mislead the Bank. Under these circumstances summary judgment will be denied as to Count V.

V. Breach of Warranties and Representations

Count VII of the complaint alleges breach of warranty. Plaintiff argues that defendants have breached warranties and representations made in the mortgage deed of trust and assignment as to whether there is any threatened or pending litigation affecting the properties in question. Plaintiff contends that a non-waiver agreement between Grace and Centex, entered into after Grace learned that the wells were unproductive, indicated that the parties were considering litigation. According to plaintiff this constituted "threatened" litigation. The court disagrees with this analysis. Under the circumstances described by plaintiff no suit would have been threatened against the Grace properties but against Centex. Accordingly, summary judgment will be granted as to Count VII.

VI. Constructive Trust

In Count VIII of the complaint plaintiff requests imposition of a constructive trust with regard to the amounts received by GPC from Centex pursuant to the settlement agreement between them. Since a constructive trust will be imposed only where there is wrongdoing on the part of the legal owner of the property in question, *see, Commodities Futures Trading Commission v. Heritage Capital Advisory Services, Ltd.*, No. 86-2763, slip op. at 3 (7th Cir. June 22, 1987), the court will reserve judgment on the constructive trust count until after a decision is made by the jury as to the alleged wrongdoing.

CONCLUSION

The motion for summary judgment is granted as to Counts I, II, III, IV, VI and VII and denied as to Counts V and VIII.

IT IS SO ORDERED.

/s/ HARRY D. LEINENWEBER
Harry D. Leinenweber, Judge
United States District Court

DATED: September 18, 1987

JUDGMENT—ORAL ARGUMENT

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

No. 88-2275

June 21, 1989.

Before
HON. WILLIAM J. BAUER, *Chief Judge*
HON. RICHARD A. POSNER, *Circuit Judge*
HON. KENNETH F. RIPPLE, *Circuit Judge*

FEDERAL DEPOSIT INSURANCE CORPORATION,
a federal corporation,

Plaintiff-Appellee,

—v.—

W.R. GRACE & CO., a Connecticut Corporation, and GRACE PETROLEUM CORPORATION, a Delaware Corporation,

Defendants-Appellants.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION.
NO. 84 C 5031
JUDGE HARRY D. LEINENWEBER

This cause was heard on the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, IT IS ORDERED AND ADJUDGED by this Court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED IN PART, REVERSED IN PART, and the cause is REMANDED WITH DIRECTIONS, in accordance with the opinion of this Court filed this date. There shall be no award of costs in this court.

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

No. 88-2275

September 11, 1989.

Before

HON. WILLIAM J. BAUER, *Chief Judge*
HON. RICHARD A. POSNER, *Circuit Judge*
HON. KENNETH F. RIPPLE, *Circuit Judge*

FEDERAL DEPOSIT INSURANCE CORPORATION,

Plaintiff-Appellee,

—v.—

W.R. GRACE & CO. and GRACE PETROLEUM CORPORATION,

Defendants-Appellants.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION.
NO. 84 C 5031
HARRY D. LEINENWEBER, *JUDGE*

ORDER

On July 5, 1989, defendants-appellants filed a petition for rehearing with suggestion for rehearing en banc. All of the judges on the original panel have voted to deny the petition, and none of the active judges has requested a vote on the suggestion for rehearing en banc. The petition is therefore DENIED.

Name of Assigned Judge or Magistrate	HARRY D. LEINENWEBER
Case Number	84 C 5031
Date	July 1, 1988
Case Title	F.D.I.C. VS. W. R. GRACE

* * *

(1) ☒ Judgment is entered as follows: (2) ☐ [Other docket entry:]

The Court ordered remittitur having been accepted by the plaintiff, the judgment against defendants' heretofore entered on October 20, 1987, docketed on October 22, 1987 is hereby modified by reducing the judgment of $75 million in punitive damages to $25 million. The judgment of $25 million in compensatory damages remains the same.

* * *

* For purposes of printing, portions of the form minute order of the United States District Court, Northern District of Illinois, Eastern Division have been omitted.

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS
Eastern Division

Docketed July 5, 1988

JUDGMENT IN A CIVIL CASE
CASE NUMBER: 84 C 5031

FEDERAL DEPOSIT INSURANCE CORPORATION

v.

W. R. GRACE AND COMPANY, ET AL

☐ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☒ Decision by Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED

The court ordered remittitur having been accepted by the plaintiff, the judgment against defendants' heretofore entered on October 20, 1987, docketed on October 22, 1987 is hereby modified by reducing the judgment of $75 million in punitive

damages to $25 million. The judgment of $25 million in compensatory damages remains the same.

July 1, 1988
Date

H. STUART CUNNINGHAM
Clerk

WANDA PARKER
(By) Deputy Clerk

Name of Assigned Judge	HARRY D. LEINENWEBER
Case Number	84 C 5031
Date	June 17, 1988
Case Title	FEDERAL DEPOSIT INSURANCE CORP. V. W. R. GRACE & CO., et al

* * *

(1) ☐ Judgment is entered as follows: (2) ☒ [Other docket entry:]

The motion of defendants' to amend the judgment is denied.

* * *

ORDER

Pursuant to Rule 59(e), Fed. R. Civ. P., defendants have moved to amend the judgment of October 20, 1987 (which was docketed on October 22, 1987) to provide language stating that the compensatory damage award would reduce the outstanding balance on the production payment loan. Defendants have suggested language to the court. Plaintiff objects to the motion as unnecessary and in the alternative has suggested substitute language to the court.

In the opinion of the court the common law provides for the application of the compensatory judgment proceeds in this case and therefore it is unnecessary for the judgment to so provide.

Accordingly, the motion of defendants to amend the judgment is therefore denied.

IT IS SO ORDERED.

ENTER:

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* For purpose of printing portions of the form minute order of the United States District Court, Northern District of Illinois, Eastern Division have been omitted.

Name of Assigned Judge or Magistrate	HARRY D. LEINENWEBER
Case Number	84 C 5031
Date	June 10, 1988
Case Title	FEDERAL DEPOSIT INSURANCE CORPORATION VS. W. R. GRACE & COMPANY, ET AL

* * *

(1) ☐ Judgment is entered as follows: (2) ☒ [Other docket entry:]

The judgment entered on June 6, 1988 is vacated. The motion for the JNOV is denied. The motion for a new trial on all issues is denied. A remittitur of fifty million dollars is ordered on the punitive damages from seventy-five million dollars to twenty-five million dollars. If the remittitur is not accepted the court will grant a new trial limited solely to the issue of punitive damages. ENTER AMENDMENT TO MEMORANDUM OPINION AND ORDER.

* * *

* For purposes of printing portions of the form minute order of the United States District Court, Northern District of Illinois, Eastern Division have been omitted.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

FEDERAL DEPOSIT INSURANCE CORPORATION, a federal corporation,	x	
Plaintiff,	x	No. 84 C 5031
v.	x	
W. R. GRACE & COMPANY, et al,	x	JUDGE LEINENWEBER
Defendants.	x	

AMENDMENT TO
MEMORANDUM OPINION AND ORDER

The court has been asked to clarify the "Judgment" issued on June 6, 1988. The document you refer to, "Judgment in a Civil Case," should not have been executed because an order granting remittiturs in lieu of a new trial is not an appealable order. *Higgins v. Smith Intern, Inc.*, 716 F.2d 278, 281 (5th Cir. 1983). The order of the court is as follows:

> The judgment entered on June 6, 1988 is vacated. The motion for the JNOV is denied. The motion for a new trial on all issues is denied. A remittitur of fifty million dollars is ordered on the punitive damage judgment only reducing the award of punitive damages from seventy-five million dollars to twenty-five million dollars. If the remittitur is not accepted the court will grant a new trial limited solely to the issue of punitive damages.

IT IS SO ORDERED.

/s/ HARRY D. LEINENWEBER
Harry D. Leinenweber, Judge
United States District Court

DATED: June 10, 1988

UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF ILLINOIS
Eastern Division

JUDGMENT IN A CIVIL CASE
CASE NUMBER: 84 C 5031

FEDERAL DEPOSIT INSURANCE CORPORATION

v.

W. R. GRACE AND COMPANY, ET AL .

☐ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☒ Decision by Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED

Grace's alternative motion for a remittitur is granted and a new trial on the issue of damages will be granted unless the FDIC accepts the remittitur to the sum of Twenty-five million dollars.

June 6, 1988
Date

H. STUART CUNNINGHAM
Clerk

/s/ WANDA PARKER
(By) Deputy Clerk

Name of Assigned Judge or Magistrate	HARRY D. LEINENWEBER
Case Number	84 C 5031
Date	October 20, 1987
Case Title	F.D.I.C. V. W. R. GRACE

* * *

(1) ☒ Judgment is entered as follows: (2) ☐ [Other docket entry:]

The jury, finds for the plaintiff F.D.I.C. and against the defendants W. R. Grace and Company and Grace Petroleum Corporation and assess compensatory damages against W. R. Grace and Company and Grace Petroleum Corporation, jointly and severally in the sum of $25,000,000.00. The jury assess punitive damages against W. R. Grace and Co. and Grace Petroleum Corporation, jointly and severally in the sum of $75,000,000.00. The court enters judgment in favor of the plaintiff and against the defendants. Trial ends—jury.

* * *

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* For purposes of printing portions of the form minute order of the United States District Court, Northern District of Illinois, Eastern Division have been omitted.

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

Docketed Oct. 22, 1987

JUDGMENT IN A CIVIL CASE
CASE NUMBER: 84 C 5031
Judge Leinenweber

F.D.I.C.

v.

W. R. GRACE, ET AL

☒ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☐ Decision by Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED

The jury, finds for the plaintiff F.D.I.C. and against the defendants' W. R. Grace and Company and Grace Petroleum Corporation and assess compensatory damages against W. R. Grace and Company and Grace Petroleum Corporation, jointly and severally in the sum of $25,000,000.00. The jury assess punitive damages against W. R. Grace and Co. and Grace Petro-

leum Corporation, jointly and severally in the sum of $75,000,000.00. The court enters judgment in favor of the plaintiff and against the defendants.

October 20, 1987	H. STUART CUNNINGHAM
Date	*Clerk*
	/s/ WANDA PARKER
	(By) Deputy Clerk

IN THE UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

Chicago, Illinois

No. 84 C 5031

December 5, 1989
10:00 o'clock a.m.

CONTINENTAL ILLINOIS NATIONAL BANK and TRUST COMPANY OF CHICAGO,

Plaintiff,

—vs.—

W.R. GRACE & CO., et al.,

Defendants.

TRANSCRIPT OF PROCEEDINGS
BEFORE THE HONORABLE JOHN F. GRADY

APPEARANCES:

For the Plaintiff: HOPKINS & SUTTER
Three First National Plaza
Suite 4200
Chicago, Illinois 60602, by
MR. WILLIAM E. RATTNER

For the Defendants: SCHIFF, HARDIN & WAITE
7200 Sears Tower
Chicago, Illinois 60606, by
MR. W. DONALD MCSWEENEY
MR. ALLAN HORWICH

CAHILL, GORDON & REINDEL
80 Pine Street
New York, New York 10005, by
MR. DENIS MCINERNEY
MR. CHARLES GILMAN

Court Reporter: LAURA M. BRENNAN
219 South Dearborn Street
Room 2524-A
Chicago, Illinois 60604
(312) 427-4393

(The following proceedings were had in open court:)

THE CLERK: 89 C 5031, Continental v. Grace, for status hearing.

MR. RATTNER: Good morning, your Honor. I am William Rattner from Hopkins and Sutter, and I represent the FDIC as successor to Continental Bank.

MR. MCSWEENEY: Good morning, your Honor. Donald McSweeney for the defendants with my partner Allan Horwich. Also, your Honor, I want to introduce you to Denis McInerney and Charles Gilman of the New York bar who are with us representing these two defendants.

THE COURT: Good morning.

I see that this is a case that I had originally, and then it went to Judge Leinenweber.

MR. RATTNER: Yes, your Honor. If you want briefly, I have jotted these dates down.

This case was originally filed back in June of 1984 by Continental Bank against W.R. Grace and its Grace Petroleum subsidiary.

The case, as it wound up, was a common law fraud case for fraud in the inducement of a $75 million loan.

In September of '84, of course, Continental went down, and FDIC replaced it as the party in this case. That was September 26, 1984.

You had the case from June of 1984 until some time in the spring or early summer of 1986 when Judge Leinenweber was appointed to the bench. This case became his at that time.

From that time through October he handled it, and there was a jury trial in October of 1987. At that time there was a jury verdict in the amount of $25 million of compensatory damages and $75 million of punitive damages.

Judge Leinenweber remitted the punitive from 75 to 25. So the verdict of 25 and 25 was appealed by Grace. In an opinion in June 1989—I don't know if you have seen it, your Honor. I did—

THE COURT: I probably did when it came out.

MR. RATTNER: Well, I brought one for you. That is the opinion of June 1989, and in essence, through Judge Posner, they affirmed the finding of liability that there had been fraud committed on the bank by Grace and its subsidiary. They then discussed punitive damages and approved the punitive damages both as to the entitlement to them and the amount.

Then Judge Posner objected to the manner in which compensatory damages had been set. He set forth for the Court his own measure of compensatory damages.

Then going back to the subject of punitive, he said that because punitive damages are set in relation to compensatory, although he could allow them to stand, he was remanding for both compensatory and punitive damages. So, therefore, as we stand now, the liability has been affirmed, and the matter has been remanded to this Court for hearing on damages in toto.

Grace applied for a petition for a rehearing. That was denied on the 11th of September of this year, and it has found its way back down to you.

THE COURT: I got it again by lot which is interesting.

MR. RATTNER: I understand that.

THE COURT: It shows you what the laws of probability are capable of doing.

MR. RATTNER: It is like a bad penny.

MR. MCSWEENEY: Your Honor, I would add that—putting aside what Judge Posner said he could have done, what he did do was really, in effect, vacated it as to all damages.

MR. RATTNER: Correct.

MR. MCSWEENEY: That is where we are today. Now, I would tell you what we are at this point planning; that is, we are going to be filing probably on the 7th, later this week, our petition for certiorari to the Supreme Court of the United States.

THE COURT: I suppose the case is ready for trial aside from that.

MR. MCSWEENEY: Not really, your Honor.
Do you want to speak to that?

MR. RATTNER: Go ahead, and then I will give my view.

MR. MCSWEENEY: The plaintiff did not put in, as the Court of Appeals pointed out, any proof as to damages. They really tried to get recision. That was rejected by the jury, but the jury did award compensatory damages. That's the basis on which it was reversed.

Then, as Mr. Rattner points out, Judge Posner did suggest his own formula for the measure of damages. So that would include, among other things, what the bank would have alternatively done with the 75 million if they had not loaned it to us, or a portion of it, if they had not loaned. There has been really no discovery with respect to damages, certainly not on that theory.

So there is—I would think there may be some substantial amount of discovery—

THE COURT: That does not sound substantial to me.

MR. MCSWEENEY: Well, the alternative use—

THE COURT: That is about a 30-minute undertaking.

MR. MCSWEENEY: Well, your Honor, the alternative use—you have some familiarity with the use to which the Continental Bank put its money—

THE COURT: They might have lent it to Penn Square.

MR. MCSWEENEY: Yes, they might have. That's right.

MR. RATTNER: Or to AT&T.

MR. MCSWEENEY: Well, they might, but they have got to see what the real—realistically they would have done with it.

THE COURT: That is not much.

MR. MCSWEENEY: Then I presume you know the plaintiff at the trial didn't use any expert witnesses.

THE COURT: Well, I am not going to put you on trial tomorrow morning anyway. There will be ample time for whatever discovery might be necessary.

I do not want you to discover this thing to death at this point because it seems—

MR. RATTNER: Oh, no.

THE COURT: I will obviously have to read Judge Posner's opinion. I do not recall the details of it at this time.

Do not go out and spend your clients into the poor house here with unnecessary discovery. If either side thinks that there is excessive discovery going on, come on in here and tell me, and I will stop it.

MR. MCSWEENEY: Very well, your Honor.

THE COURT: Aside from that, I will leave you to your own devices.

Let's talk in terms of a trial date. I might as well give you a trial date. I am inclined to give you one notwithstanding the cert petition because we all know how often those are granted. Obviously, I will not try it while the petition is still pending.

Let's set a date at about the time you think the Court might rule on the petition. Do you have any idea of that at this point?

MR. MCINERNEY: I think, your Honor, we are going to file it in two days. Most likely by June anyhow, I would think. As you know—

THE COURT: By June.

MR. RATTNER: In terms of schedules, do you think that late summer, early fall would be a realistic time for a trial, and not before then? I have a big one coming up in Texas in July.

MR. MCINERNEY: I would think the fall.

MR. MCSWEENEY: The fall would be preferred, I think.

MR. RATTNER: We did well in fall the first time. I don't mind it now.

THE COURT: How long do you expect the trial to take?

MR. RATTNER: Your Honor, here is the problem with that. Were it simply a matter of compensatory damages, I think we would be talking a couple of days, three or four days.

The trouble is that the Court has approved under the facts of this case and with its finding of liability the award of punitive damages.

In order to really show a jury why we are entitled to substantial punitive damages, we will have to go into some of the aggravating circumstances and some of the—what the Court found to be willful circumstances of the loan and its negotiation.

So it will not be a simple statistical financial discussion by number crunchers. I would expect realistically knowing how trials can just stretch more than you think they should ten days at least, a couple of weeks of trial.

THE COURT: Okay.

MR. MCSWEENEY: It would be exculpatory material which we would want to present, too, of course, to that. I would think it would be a little longer than that, three or four weeks probably.

THE COURT: Let me warn you so that you can have it in mind while you are preparing, I will not want cumulative evidence. Each side will, obviously, have an opportunity to present

its case, but do not figure on bringing in expert after expert to say essentially the same thing.

MR. MCSWEENEY: No.

THE COURT: Okay. How about September 10?

MR. MCSWEENEY: Fine.

THE COURT: We will set it for a pretrial status hearing on July 10 at 9:45.

MR. RATTNER: Very well.

MR. MCSWEENEY: That is fine. Thank you, your Honor.

THE COURT: Thank you.

(Which concluded the proceedings in the above-entitled matter.)

APPLICABLE PROVISIONS OF THE UNITED STATES CONSTITUTION

AMENDMENT V [1791]

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

* * *

AMENDMENT VII [1791]

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.

* * *

AMENDMENT VIII [1791]

Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted.

* * *

AMENDMENT XIV [1868]

Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any

State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

APPLICABLE PROVISIONS OF THE FEDERAL DEPOSIT INSURANCE ACT*

§ 1811. Creation of Corporation; duties

There is created a Federal Deposit Insurance Corporation (hereinafter referred to as the "Corporation") which shall insure, as hereinafter provided, the deposits of all banks and savings associations which are entitled to the benefits of insurance under this chapter, and which shall have the powers hereinafter granted.

* * *

§ 1812. Management

(a) Board of directors.

(1) In General. The management of the Corporation shall be vested in a Board of Directors consisting of 5 members—

(A) 1 of whom shall be the Comptroller of the Currency;

(B) 1 of whom shall be the Director of the Office of Thrift Supervision; and

(C) 3 of whom shall be appointed by the President, by and with the advice and consent of the Senate, from among individuals who are citizens of the United States.

(2) Political Affiliation. After February 28, 1993, not more than 3 of the members of the Board of Directors may be members of the same political party.

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* The Federal Deposit Insurance Act was substantially amended by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (Aug. 9, 1989). Those provisions reproduced herein that have no asterisk next to their title reflect the present codification of the Act. Those that do have an asterisk reflect the prior codification of the Act, and represent the civil penalties scheme in place while this action was being litigated.

§ 1817. Assessments*

Reports of condition; access to bank examination reports

(a)(1) Each insured State nonmember bank (except a District bank) and each foreign bank having an insured branch which is not a Federal branch shall make to the Corporation reports of condition which shall be in such form and shall contain such information as the Board of Directors may require. Such reports shall be made to the Corporation on the dates selected as provided in paragraph (3) of this subsection and the deposit liabilities shall be reported therein in accordance with and pursuant to paragraphs (4) and (5) of this subsection. The Board of Directors may call for additional reports of condition on dates to be fixed by it and may call for such other reports as the Board may from time to time require. The Board of Directors may require reports of condition to be published in such manner, not inconsistent with any applicable law, as it may direct. Every such bank which fails to make or publish any such report within ten days shall be subject to a penalty of not more than $100 for each day of such failure recoverable by the Corporation for its use.

* * *

(j)(16) Any person who willfully violates any provision of this subsection, or any regulation or order issued by the appropriate Federal banking agency pursuant thereto, shall forfeit and pay a civil penalty of not more than $10,000 per day for each day during which such violation continues. The appropriate Federal banking agency shall have authority to assess such a civil penalty, after giving notice and an opportunity to the person to submit data, views, and arguments, and after giving due consideration to the appropriateness of the penalty with respect to the size of financial resources and good faith of the person charged, the gravity of the violation, and any data, views, and arguments submitted. The agency may collect such civil penalty by agreement with the person or by bringing an action in the appropriate United States district court, except that in any such action, the person against whom the penalty has been assessed shall have a right to trial de novo.

* * *

§ 1818. Termination of status as insured bank*

(i) Jurisdiction and enforcement; penalty

(2)(i) Any insured bank which violates or any officer, director, employee, agent, or other person participating in the conduct of the affairs of such a bank who violates the terms of any order which has become final and was issued pursuant to subsection (b), (c), or (s) of this section, shall forfeit and pay a civil penalty of not more than $1,000 per day for each day during which such violation continues: *Provided*, That the agency having authority to impose a civil money penalty may, in its discretion, compromise, modify, or remit any civil money penalty which is subject to imposition or has been imposed under such authority. The penalty may be assessed and collected by the appropriate Federal banking agency by written notice. As used in this section, the term "violates" includes without any limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation.

* * *

§ 1819. Incorporation; powers; seal

* * *

(b) Agency authority.

(1) Status. The Corporation, in any capacity, shall be an agency of the United States for purposes of section 1345 of title 28, United States Code, without regard to whether the Corporation commenced the action.

* * *

§ 1825. Issuance of notes, debentures, bonds, and other obligations; exemption from taxation

* * *

(d) Full faith and credit. The full faith and credit of the United States is pledged to the payment of any obligation issued

after the date of the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 by the Corporation, with respect to both principal and interest, if—

(1) the principal amount of such obligation is stated in the obligation; and

(2) the term to maturity or the date of maturity of such obligation is stated in the obligation.

* * *

§ 1827. Reports by Corporation; audit of financial transactions; report on audits; employment of certified public accountants for audits

(a) Annual reports of BIF, SAIF, and the FSLIC Resolution Fund.

(1) In General. The Corporation shall annually submit a full report of its operations, activities, budget, receipts, and expenditures for the preceding 12-month period. The report shall include, with respect to the Bank Insurance Fund, the Savings Association Insurance Fund, and the FSLIC Resolution Fund, an analysis by the Corporation of—

(A) the current financial condition of each such fund;

(B) the purpose, effect, and estimated cost of each resolution action taken for an insured depository institution during the preceding year;

(C) the extent to which the actual costs of assistance provided to, or for the benefit of, an insured depository institution during the preceding year exceeded the estimated costs of such assistance reported in a previous year under paragraph (A);

(D) the exposure of each insurance fund to changes in those economic factors most likely to affect the condition of that fund;

(E) a current estimate of the resources needed for the Bank Insurance Fund, the Savings Association Insurance Fund, or the FSLIC Resolution Fund to achieve the purposes of this Act; and

(F) any findings, conclusions, and recommendations in legislative and administrative actions considered appropriate to future resolution activites by the Corporation.

(2) Manner of Submission. Such report shall be submitted to the President of the Senate and the Speaker of the House of Representatives, who shall cause the same to be printed for the information of Congress, and the President as soon as practicable after the first day of January each year.

* * *

(d) Audit of Corporation.

(1) Audit Required. The Comptroller General shall audit annually the financial transactions of the Corporation, the Bank Insurance Fund, the Savings Association Insurance Fund, and the FSLIC Resolution Fund in accordance with generally accepted government auditing standards.

(2) Access to Books and Records. All books, records, accounts, reports, files, and property belonging to or used by the Corporation, the Bank Insurance Fund, the Savings Association Insurance Fund, and the FSLIC Resolution Fund, or by an independent certified public accountant retained to audit the Fund's financial statements, shall be made available to the Comptroller General.

* * *

§ 1828. Regulations governing insured banks*

(a) Display of signs

Every insured bank shall display at each place of business maintained by it a sign or signs, and shall include a statement to the effect that its deposits are insured by the Corporation in all of its advertisements: *Provided*, That the Board of Directors may exempt from this requirement advertisements which do not relate to deposits or when it is impractical to include such statements therein. The Board of Directors shall prescribe by regulation the forms of such signs and the manner of display and the substance of such statements and the manner of use. For each

day an insured bank continues to violate any provisions of this subsection or any lawful provisions of said regulations, it shall be subject to a penalty of not more than $100, which the Corporation may recover for its use.

* * *

(h) Penalties

Any insured bank which willfully fails or refuses to file any certified statement or pay any assessment required under this chapter shall be subject to a penalty of not more than $100 for each day that such violations continue, which penalty the Corporation may recover for its use: *Provided*, That this subsection shall not be applicable under the circumstances stated in the proviso of subsection (b) of this section

* * *

(j) Provisions relating to loans, extensions of credit, and other dealings between member banks and their affiliates; executive officers, directors, etc., applicable to nonmember insured banks; penalty; inapplicability to insured Federal savings banks.

(4)(A) Any nonmember insured bank which violates or any officer, director, employee, agent, or other person participating in the conduct of the affairs of such nonmember insured bank who violates any provision of section 371c, 371c-1, or 375b of this title, or any lawful regulation issued pursuant thereto, or any provision of section 377 of this title, shall forfeit and pay a civil penalty of not more than $1,000 per day for each day during which such violation continues: *Provided*, That the Corporation may, in its discretion, compromise, modify, or remit any civil money penalty which is subject to imposition or has been imposed under authority of this subsection. The penalty may be assessed and collected by the Corporation by written notice. As used in this section, the term "violates" includes without any limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation.

* * *

§ 1829. Conditions governing employment of personnel*

Except with the written consent of the Corporation, no person shall serve as a director, officer, or employee of an insured bank who has been convicted, or who is hereafter convicted, of any criminal offense involving dishonesty or a breach of trust. For each willful violation of this prohibition, the bank involved shall be subject to a penalty of not more than $100 for each day this prohibition is violated, which the Corporation may recover for its use.

* * *

§ 1833a. Civil penalties

* * *

(b) Maximum amount of penalty.

(1) Generally.

The amount of the civil penalty shall not exceed $1,000,000.

(2) Special rule for continuing violations.

In the case of a continuing violation, the amount of the civil penalty may exceed the amount described in paragraph (1) but may not exceed the lesser of $1,000,000 per day or $5,000,000.

(3) Special rule for violations creating gain or loss.

(A) If any person derives pecuniary gain from the violation, or if the violation results in pecuniary loss to a person other than the violator, the amount of the civil penalty may exceed the amounts described in paragraphs (1) and (2) but may not exceed the amount of such gain or loss.

(B) As used in this paragraph, the term "person" includes the Bank Insurance Fund, the Savings Association Insurance Fund, and the National Credit Union Share Insurance Fund.

* * *

(d) Attorney general to bring action.

A civil action to recover a civil penalty under this section shall be commenced by the Attorney General.

* * *